DEATH, TAXES, AND CUSTOMER RETURNS:

Turning the Unavoidable into a Supply Chain Opportunity

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Introduction

According to a May 2014 report by Forrester Research, online sales are forecast to grow 57 percent by 2018, from $263 billion in 2013 to $414 billion. Given that roughly 17 percent of online purchases are returned, that means online retailers can look forward to more than $70 billion in annual returns—$70 billion in annual returns. Clearly a daunting figure that should be a wake-up call to any business engaged in online sales.

The numbers are equally jarring for U.S. businesses engaged in online sales to Canada. Canadian eCommerce has surged in recent years and is expected to grow at an annual rate of at least 10 percent in each of the next five years, with two-thirds of Canadian shoppers expected to make purchases from U.S. websites. This surge in eCommerce sales to Canada is causing a corresponding spike in returns back to the U.S. Goods that leave the U.S. as exports come back as imports, requiring a trip across the border and a stop at U.S./Canada customs compliance, yet another logistical consideration to bear in mind.

But as unwelcome and logistically challenging as product returns may be, businesses today are starting to recognize the potential of a well-managed returns management policy, namely, through resale and other revenue-generating opportunities and as a unique opportunity to connect with customers.

Unfortunately though, this change in mind-set seems to be rather slow in coming. Dr. Dale Rogers, professor of logistics and supply chain management at Rutgers University, told Logistics Management that when it comes to businesses recognizing the need for a policy or process to manage returns, "[m]ost companies are not there yet. They still need to spend more quality management time carefully examining and constructing their reverse logistics processes."

Dr. Rogers's assessment is supported by research from Intermec Research, which found more than half of all businesses surveyed do not have the capability to determine if returned goods should be discarded, returned to vendor, or moved back into inventory. The Intermec survey also found 44 percent of distribution center managers consider returns a "pain point" in their operations.

But with the rate of returns expected to continue on an upward trajectory, smart businesses are recognizing the need to take control and, in some cases, are turning returns management into profit centers. Whereas in the past, returns might have been allowed to gather in a pile, and "out of sight, out of mind" seemed to be the modus operandi, businesses are increasingly incorporating reverse logistics strategies into their supply chains.

For one thing, fewer than 20 percent of returns are damaged. This means businesses are taking in perfectly good merchandise that holds potential value for resale in a secondary market. Together with unsold merchandise and excess inventory, the global market for secondary goods is estimated at $60 billion to $80 billion.

Reverse logistics, defined by Reverse Logistics magazine as "the process of planning, implementing, and controlling the efficient flow of goods from the point of consumption to the point of origin for purposes of recapturing value or proper disposal," is now seen as a critical component of the bottom line.

As important as the decision to develop a reverse logistics strategy, so are the components of that strategy. A good strategy will help a business:

- Improve customer satisfaction/retention
- Reduce processing and transportation costs
- Recapture revenue on the secondary market
- Capture critical product performance data—i.e., Why are high levels of a certain product returned?

The following discussion will provide a contextual overview of U.S. business practices with regard to managing returns. This paper will examine the advantages of a properly maintained returns process and discuss important options to consider in developing a reverse logistics strategy.

Product Returns—What's Behind the Increase?

ANNUAL U.S. MERCHANDISE RETURNS AND RETURN FRAUD

METRIC	2012	2013
NRF retail industry sales(1)	$3,006	$3,108(2)
Returns as a percent of total sales	8.77%	8.60%
Amount of merchandise returned	$263.1	$267.3
Percent of returns without a receipt	17.3%	14.4%
Return fraud as a percent of total returns	3.4%	3.4%
Estimated amount of fraudulent returns	$8.8	9.1%
Return fraud and abuse as a percent of total returns(3)	6.0%	6.1%
Estimated amount of return fraud and abuse	$15.8	$16.3

(1) The National Retail Federation's U.S. retail industry sales figure includes most traditional retail categories including non-store, auto parts and accessories stores, discounters, department stores, grocery stores, and specialty stores, and exclude sales at automotive dealers, gas stations, and restaurants. Sales and returns are reported in billions of dollars. (2) 2013 retail sales estimated by NRF. (3) Return fraud and abuse estimates are derived from trends established in previous years of the Consumer Returns in the Retail Industry report.

Analysis of National Retail Federation data by the Retail Equation found that consumer returns during 2013 exceeded $267 billion.
Source: theretailequation.com/

Until recently, the typical sales transaction ended with an exchange of payment for goods and the issuance of a sales receipt. But this is not so anymore. Today, there is a one in nine percent chance that the retailer will see that product again in the form of a customer return. The National Retail Federation (NRF) estimates that consumer returns totaled more than $267 billion during 2013, a 12 percent increase since 2008. Analysis of NRF data by The Retail Equation found that "if merchandise returns were a company, it would rank #3 on the Fortune 500." This upward trajectory is expected to continue, at least for the foreseeable future.

Many businesses turned a blind eye to customer returns in the past, not wanting to invest the necessary manpower and resources to process the growing pile of rejected merchandise. Proper processing typically adds many touch points to the supply chain, including customer service, warehouse operations, finance, transportation, distribution, and sales. The typical business tended to focus on generating new sales, not rectifying issues with past sales.

All that has changed though as increased numbers of returns have given businesses little choice but to actively address what has become a strain on their bottom line. But before a business decides how to implement a strategy for returns management, it's necessary to look at why products are being returned. A 2009 survey by the Supply Chain Consortium reported six top reasons products are returned. These categories represent nearly 75 percent of all reasons for returns:

TOP REASONS FOR CONSUMER RETURNS

Customer ordered incorrect product or size

Customer decided product not needed or wanted

Customer returned with no reason given

Product did not fit description on website or in catalog

Product did not fit customer's expectation

Company shipped incorrect product or size

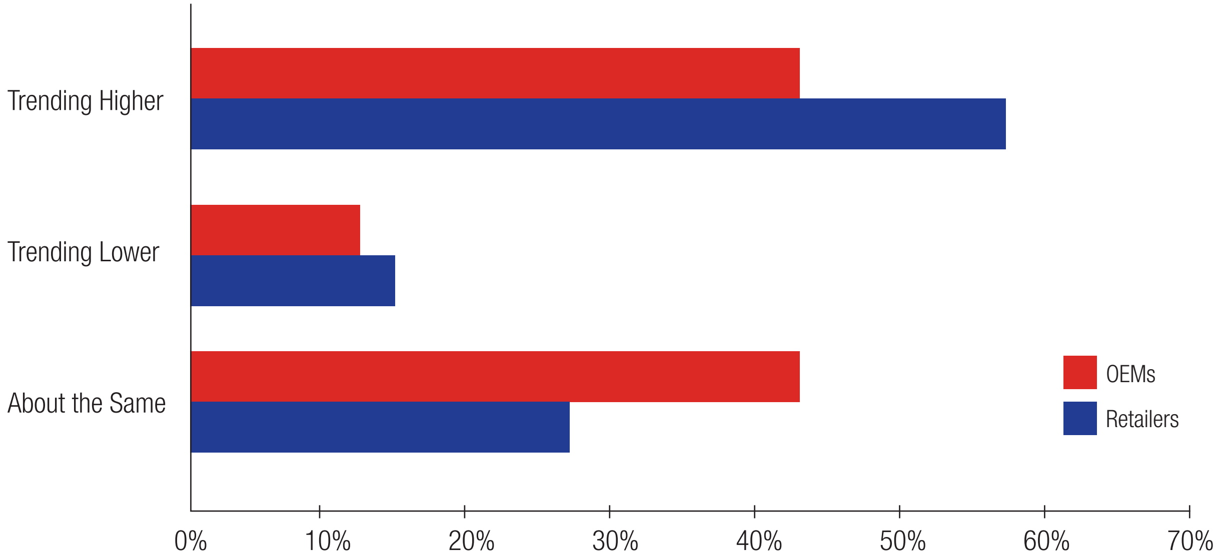
Source: Tompkins International, 2009

The volume of returns has been magnified by the surge in online sales. While rates of return vary depending on product category, rates of returns for products purchased online are generally twice the rate of returns for products purchased in-store. Online shoppers display different shopping behaviors than in-store consumers. Web shoppers frequently order multiple versions of the same item, but in different sizes or colors, with the intention of returning all but the best-fitting, most-appealing products. The Wall Street Journal highlighted one consumer who purchased 10 pairs of corduroy pants in different colors and sizes only to return seven of them. When asked about the costs the retailer would have to incur to take back the returns, the consumer told the Journal reporter: "I feel justified. After all, I am the customer."

Online footwear company Zappos.com has raised the bar for encouraging shoppers to "use their homes as dressing rooms," by providing free returns and a simplified, customer-friendly returns process. The company promotes its free returns shipping policy via web-based ads.

What this tells us is the overwhelming majority—80 percent by some estimates—of returns are not defective. This presents a good opportunity for a retailer or manufacturer to recapture value from the product. Undamaged merchandise can be sold in a secondary market venue, such as a manufacturer outlet store, dollar store, thrift store, auction, or via an "overstock" website.

HOW DO YOUR CURRENT RATES COMPARE TO THE PREVIOUS THREE TO FOUR YEARS?

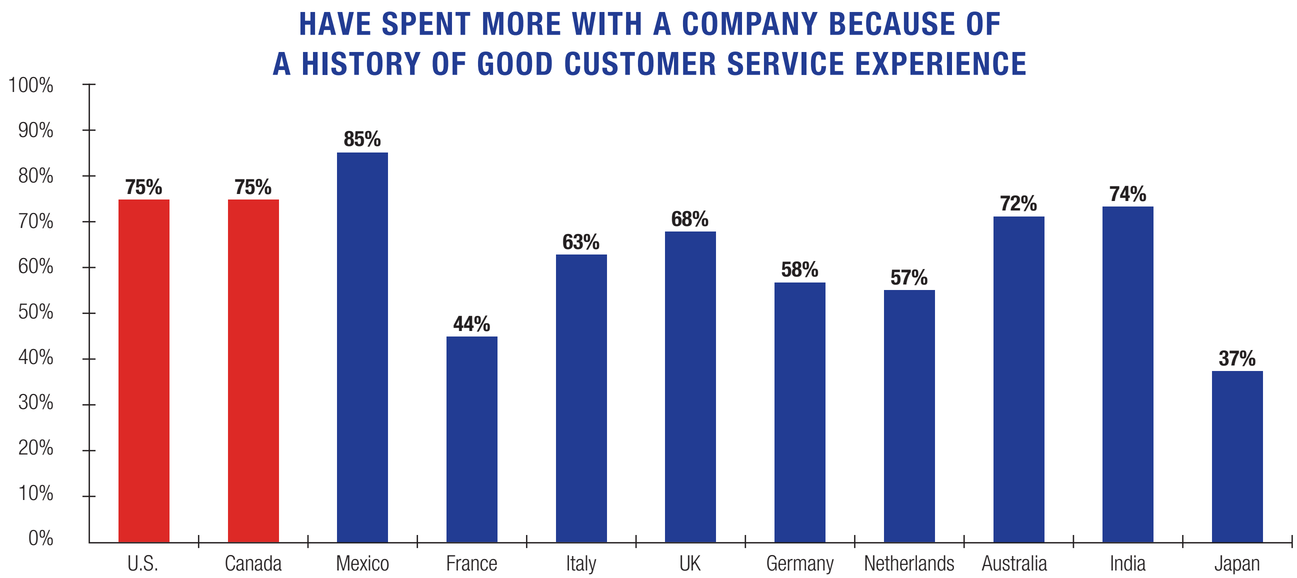


A report by Accenture consulting found a steady increase in returns among consumer electronics shoppers. But 68 percent of those returns were characterized as "no trouble found," and 27 percent associated with "buyer's remorse." Only five percent of returns were found to be defective. Source: Accenture.com

Consider the consumer electronics industry. A report by Accenture management consultants found that roughly $17 billion in consumer electronics were returned during 2012, an increase of 21 percent since 2007. But only five percent of those returns were because of breakage or product defects. Fully 68 percent of returned products were characterized as "no trouble found," which means the products met all required specifications when tested. While the Accenture report focused on ways to prevent customers from returning products in the first place, Best Buy has turned its product returns into a profit center by reselling refurbished and undamaged products through a dedicated secondary market initiative.

Returns Management—Critical to Customer Service

Not only is proper returns management a means to recapture revenue, it is critical to customer service. The 2012 American Express survey on global consumer attitudes found that in both the U.S. and Canada, 75 percent of consumers surveyed said they had spent more with a company that had historically provided good customer service. But when good service is not provided, 63 percent of Canadians and 56 percent of Americans will tell others about their poor experiences.



The 2012 American Express survey on global consumer attitudes, conducted by Echo Research, found that 75 percent of American and Canadian consumers said they have spent more on companies that have provided good customer service experiences.
Source: AmericanExpress.com

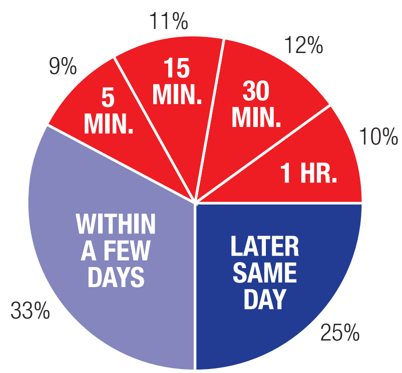
This data seems to be reinforced by a 2012 ComScore survey of online shoppers that found that 85 percent said they would not buy again from a retailer if the returns process was not convenient, while 95 percent said that they would return to a retailer with a convenient returns policy.

And once a customer is lost, it is very costly to recruit a replacement. Paul Timm points out in Seven Power Strategies for Building Customer Loyalty, "[t]he alternative to building customer loyalty is to constantly scramble to replace the inevitably lost [customers]. It costs five times as much to generate a new customer as it does to keep an existing one..."

Which is one final data point that emphasizes growing customer expectations for good customer service. A 2012 Edison Group survey found that 42 percent of consumers who contact a company via social media expect to have a response within 60 minutes. And 20 percent believe that response should come within 20 minutes.

MOST WHO USE SOCIAL MEDIA FOR CUSTOMER SERVICE EXPECT A VERY QUICK RESPONSE

"In general, how soon after you contact a brand, product, or company on social media do you expect to receive a response?"



An Edison Group survey found that 42 percent of consumers who contact a company via social media expect a response within 60 minutes.

Base: Ever attempted to contact a brand, product, or company through social media for customer service/support?

Source: Edison Research

With that in mind, businesses are increasingly implementing returns processes that make the transaction as easy as possible for the consumer. Zappos.com raised the bar with its "free returns, no questions asked" policy. While most businesses cannot afford to be as generous, customer satisfaction can be attained in other ways:

- Including a return label with the original shipment
- 24/7 tracking capability
- Efficient problem resolution
- Personable/Interactive customer service

How a company chooses to handle returns can have a significant impact on the bottom line, as well as on relationships with customers. Handled efficiently, returns can actually be a source of revenue, adding as much as five percent to total sales.

Solutions—Determine Your Best Returns Process

Once your business has decided on the terms of your returns policy (i.e., how many days from point of sale will returns be accepted, whether to issue refunds or credit, is original packaging mandatory), the next step is to work with your logistics partner to develop a plan for (a) allowing customers to send returns and (b) managing the intricacies of the process. Included in this must be accommodations for accepting returns from non-U.S. customers. Your Canadian customers, for example, expect the same level of customer service and visibility as your U.S. customers. But accepting returns from international customers will trigger an entirely separate set of considerations, ranging from border clearance to distribution networks. A logistics provider with direct experience in the Canadian market will be best suited to help navigate the process of bringing goods back into the U.S.

Not surprisingly, technology and "better thinking" have enabled many innovations in returns management logistics. Today a business can have in place a returns strategy that is every bit as effective and cost efficient as its outbound logistics plans. Among other things, a technology-driven returns strategy does the following:

- Allows business insight into the volume of returns
- Provides businesses with a "heads up" to any potential product defect
- Prevents returns from being incorrectly addressed or delivered
- Triggers shipments that require special compliance or border clearance requirements
- Facilitates the returns process for consumers
- Allows 24/7 tracking capability for consumers

Clearly, technology has helped businesses gain control of their returns process. But as with most things, the devil is in the details, and a business must work closely with its logistics provider to develop a returns strategy that meets its unique needs.

A comprehensive returns strategy should include the following components:

Flexibility in Scheduling

Build a returns management strategy that gives you the level of service you need. Do you need to receive returns on a daily basis, or would a weekly or even biweekly schedule be more appropriate for your business?

Centralized Returns Centers

Where exactly do you want your returns delivered? A growing trend is to process returns at a dedicated returns center rather than via a traditional distribution center. For one thing, most distribution centers are geared toward outbound shipments rather than processing individualized returns. A dedicated returns center allows businesses to focus resources and build best practices. And problems associated with multiple retailers or consumers individually returning goods can be averted. In fact, having a dedicated returns center in place can be as much as 20 times more efficient than having multiple processing points.

Border Consolidation

If a border crossing is involved, consider having your goods consolidated at the border so that many small shipments are allowed to clear customs as a single unit. Border consolidation can facilitate the customs review process and reduce costs as well.

Integrated Returns Material Authorization (RMA)

Through the RMA process, customers must contact your business, either through an 800 number or a web-based portal, to notify you of their intention to return a product and to receive an RMA number that will serve to track their package through the returns process. A returns authorization label can be preprinted and sent to customers with the outbound shipment, and they can fill in the RMA on that label. Or a web-based system can print a label after the RMA number has been assigned. There are many advantages to the RMA process:

- Preprinted labels ensure that returns are delivered precisely where you want them to go.
- Preprinted bar codes allow you to capture precise information about the reason for return and advance notice of exactly what is being returned and when.
- RMA numbers allow employees to easily track returns and serve as a reference point.

Multichannel Visibility

The effect that your returns process will have on customer satisfaction cannot be overstated. Customers are demanding that returns be handled quickly and with complete visibility into the process. As stated previously, 85 percent of shoppers will not return to a retailer if the returns process is not convenient. Allowing visibility into the process can give customers direct information about the process of their return and some degree of explanation should a delay occur. Some news is better than no news!

- Web-based portals allow consumers 24/7 access to information about their return. Key company systems – finance, customer service, warehousing—could be integrated to give customers updated progress reports.
- Carrier integration allows RMAs to be linked with carrier tracking numbers, which can then be linked to automatically generated notifications or made available on a web-based portal

Sustainability

It’s also important to incorporate sustainability wherever possible. An obvious place to start is by finding “second lives” for returned merchandise. The 80 percent of goods that are returned with no defects can be sold in an outlet, a dollar store, or an “overstock” website. For returns that are defective, sustainability can be attained by repairing the good or by breaking it down to its component parts, which can then be sold on a secondary market.

But sustainability can easily be incorporated into your logistics process:

- Use of web-based processing eliminates paperwork.
- Dedicated returns centers reduce number of deliveries and reduce instances of products being rerouted.
- Reusable envelopes and packaging eliminate waste.
- Steps can be taken to ensure that repairs and replacement items are returned to customers in size-appropriate packaging.

Solutions—Processing Your Returns

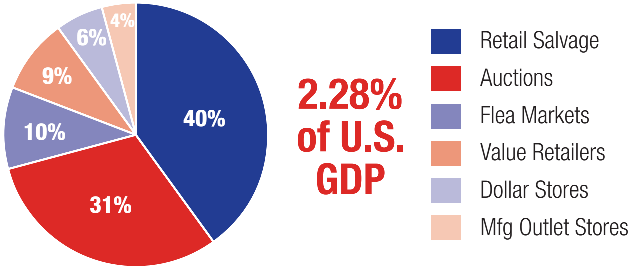
Once your customer's return arrives at your designated processing center, you will have a very short window in which to identify and resolve the reason for the return. A 2014 report on a study conducted by StellaService found that 70 percent of consumers expect resolution within 10 days. But only 36 percent of the online retailers included in the study met these expectations.

Expedited Problem Identification

Considering that only about 20 percent of returned goods are actually defective, it is essential for returned merchandise to be received, evaluated, and processed as quickly as possible. As discussed above, a dedicated returns processing center will have trained personnel who can initiate the proper response:

- **Refund/Credit.** If a refund or merchandise credit is due, this can easily be accomplished by integrating internal business functions. Off-the-shelf software solutions are available that can manage the process.
- **Replacement.** An ample inventory should be maintained at your processing center to ensure that items returned because of sizing and other nonperformance issues can be processed quickly.
- **Repair.** Be sure that your returns center has a complete supply of spare parts necessary to make repairs. Managing the repair process has traditionally been the weak link for many businesses. In fact, a report by the Reverse Logistics Association found that "managing the 'return and repair' processes account for 10 percent of overall supply chain costs." But ineffective processes can compound this cost and reduce profit by as much as 30 percent. Businesses are rectifying this problem by outsourcing their repairs or contracting with repair centers.

THE SECONDARY MARKET



According to noted returns management specialists Greve-Davis, sales of returned goods on the secondary market account for more then 2.28 percent of the U.S. gross domestic product. Source: Grevedavis.com

- **Secondary Market Sales.** The explosive growth of secondary markets has enabled many businesses to recoup lost revenue—and even turn a profit—from product returns. Goods that were previously written off as a cost of doing business are now being refurbished, repackaged, and resold. Secondary market venues include outlets, discount stores, overstock websites, auctions, and flea markets. Reverse logistics consultants Greve-Davis estimate that the value of the secondary market accounts for 2.28 percent of total U.S. gross domestic product.

Solutions—Returns from Canada

Returns management becomes even trickier when the items originate outside of the U.S. Products reentering the U.S. from Canada are international transactions and must comply with all applicable customs requirements. It should be noted though that instances of products being returned to the U.S. from Canada are hardly unusual. According to the U.S. Trade Representative, "returns" was the fifth largest import category during 2013, behind fuel and oil, vehicles, machinery, and plastic. Total returns from Canada during 2013 were valued at $10.2 billion.

TOP U.S. IMPORTS FROM CANADA—2013

$109.4 billion	Mineral Fuel and Oil (crude and natural gas)
$55.7 billion	Vehicles
$19.8 billion	Machinery
$10.6 billion	Plastic
$10.2 billion	Special Other (returns)

Source: Office of the U.S. Trade Representative

In addition to the regulatory hurdles that Canadian returns must clear, there are other issues. A U.S. business must be certain that its logistics provider can guarantee service and has a capable distribution network in place. Equally important, a U.S. business must be able to meet Canadian consumers' high expectations for customer service and convenience.

Canadian demand for U.S. goods has surged in recent years as the Canadian dollar has grown in value and eCommerce has taken root. And with this affinity for U.S. goods has come high expectations for customer service and guaranteed delivery. A 2012 survey by American Express of global consumer attitudes found that 61 percent of Canadians said that they did not complete a purchase because of poor customer service. Thus, there is little tolerance for businesses that are unable to successfully process consumer returns.

In preparing your returns management strategy, it is essential to be aware of, and to plan for, several considerations:

Returns from Canada are "International Transactions"

And like all international transactions, goods must be in compliance with all necessary paperwork filings, security procedures, and duty and tax requirements. In addition, returned goods may face additional obstacles including:

- Some defective goods may be ineligible for export or may require additional export licenses.
- Goods being imported back into the U.S. may require payment of additional duties and taxes.
- Goods being returned for repair may be regarded as "temporary imports" and therefore subject to preferable treatment (which requires completion of proper paperwork).
- Border officials may require proof of original purchase.

Intra-Canada Consolidation

An intra-Canada consolidation plan is a good way to gain control over your Canadian returns. Returns can be brought to a designated facility near the border and then held until a pre-determined date. Advantages to intra-Canada consolidation include cost efficiencies, reduced border clearance wait times, and greater flexibility.

Canadian Distribution Network is Essential

The country of Canada accounts for 3.8 million square miles, making it second only to Russia in terms of territorial size. Fortunately for U.S. businesses trying to reach the Canadian market, most of Canada's 35 million residents are located in urban areas, with 90 percent of the population living within 100 miles of the U.S. border. But in order to reach Canadian consumers living in less populated regions, an extensive intra-Canada distribution network will be needed. Many U.S. businesses make the mistake of assuming that their U.S. logistics provider will be capable of handling their Canadian shipments. Unfortunately, this is usually not the case. As these U.S. businesses have learned the hard way, there is no substitute for genuine experience and expertise in the Canadian market.

Canadian Demographics must be Considered

Because of the close proximity of the two countries, both geographically and culturally, many businesses assume that doing business in Canada is similar to U.S. business transactions. This thinking fails to take into account Canada's unique culture, procedures, and standards. For example:

- **Bilingual.** Canada is officially a bilingual country, with both English and French considered the official languages. While most Canadians speak English, more than 7 million residents speak French. Most French speakers live in Quebec, but there are pockets throughout the country where French is spoken.
- **Metric System.** Canada is also somewhat bi-lingual when it comes to measurement systems. While Canadians generally use the metric system to measure distances, speed limits, and gasoline, it is not uncommon to find venues—grocery stores—that record measurements in inches, pounds, and miles.
- **Labeling.** Just as the U.S. government imposes specific labeling requirements on products sold in this country, so does the Canadian government. The country's Consumer Packaging and Labeling Act mandates specific information that must be included on various consumer product labels—including a mandate that information must be in both English and French, and quantities expressed in metric units.

Conclusion

Consumer product returns account for as much as eight percent of a typical business's total sales, a figure that has increased by 12 percent over the past four years. As businesses have recognized the impact of returns to their bottom lines, they are increasingly implementing management strategies to recapture value from product returns and promote good customer service in the process. Successful returns management strategies can help a business add as much as five percent to overall revenue.

Businesses are realizing, among other things, that roughly 80 percent of product returns have no defects. In fact, most products are returned because the consumer ordered the wrong size, needs a different color, changed his/her mind, or because the product wasn't what he/she was expecting. These undamaged products, which were previously discarded as "unsellable," are now finding second lives in alternate venues including outlets, dollar stores, overstock websites, and auctions. The secondary market has become so important to U.S. businesses that its total value worldwide is estimated to range from $60 to $80 billion.

A well-managed returns process will enable a business to get ahead of the game, to know exactly what products are being returned and when, to have inventory in place to quickly offer replacements, or to perform repairs. And perhaps most important, a well-executed returns program will allow 24/7 insight and tracking capability for customers. This component is critically important, with 85 percent of consumers indicating that they will not return to a business that does not have a convenient returns process.

Implementing a convenient returns process can be even trickier when an international border crossing is involved. As U.S. businesses have increasingly broadened their customer bases into Canada, the rate of returns from Canada has grown significantly. Businesses need to understand the complexities of bringing goods back into the U.S. Unique customs clearance requirements must be met, duties paid, and voluminous paperwork filed. In addition, a solid distribution plan must be in place that can reach the most remote regions of Canada and that can offer a U.S. business the flexibility it needs to determine when and where returns will be sent.

Integral to building a returns management strategy, is a solid logistics partner. A good logistics partner will understand your business objectives and develop a plan that offers exactly the type of returns management process you need. Don't be fooled by a logistics provider who tries to sell you on a "one size fits all" approach. Your business is unique and so too are your logistics needs.

Purolator. We deliver Canada.

Purolator is the best-kept secret among leading U.S. companies who need reliable, efficient, and cost-effective shipping to Canada. We deliver unsurpassed Canadian expertise because of our Canadian roots, U.S. reach, and exclusive focus on cross-border shipping.

Every day, Purolator delivers more than 1,000,000 packages. With the largest dedicated air fleet and ground network, including hybrid vehicles, and more guaranteed delivery points in Canada than anyone else, we are part of the fifth largest postal organization in the world.

But size alone doesn't make Purolator different. We also understand that the needs of no two customers are the same. We can design the right mix of proprietary services that will make your shipments to Canada hassle free at every point in the supply chain.

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