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EXECUTIVE SUMMARY:

RETURNS

Returns Grow Along with Ecommerce

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The rapid growth of ecommerce and omnichannel retail operations are continuing to create returns challenges for merchants. As both the volume of returns and their value increase, companies are tapping technology solutions and third-party providers to help them handle the increasingly complex inbound side of the equation.

While overall return rates are not increasing dramatically, they are on the rise, forcing merchants to optimize their supply chain in both directions and squeeze as much value as they can out of returned merchandise. And fraud is a growing concern as the value tied to scammed returns continues to grow.

Whereas more consumers are growing accustomed to the option of rapid order fulfillment, with more merchants offering next-day or even same-day delivery in some metropolitan areas, that same expectation of immediacy is generally not there on the return side.

"Nothing has changed (with returns) because the industry is moving toward faster delivery," said Devon Downing, a workforce and system manager at Gardener's Supply. "But if the customer ordered within a reasonable timeframe, and the item is broken or damaged, we will overnight the product."

According to National Retail Federation's 2014 Return Fraud Survey, which polled senior loss prevention executives at 60 retail companies in October and November 2014, returns as a percentage of retail sales were 8.9%, up slightly from 8.6% in 2013; they have been in the 8% range for the past five years. However, the value of returned goods is rising at a faster rate: Respondents said $284 billion in goods were returned in 2014, up 6.2% from $267 billion in 2013.

The NRF survey found the percentage of holiday sales returned was 11.2% in 2014, up from 10.1% in 2013.

In terms of ecommerce returns, the 2014 State of Online Retail report from Forrester and Shop.org found the figure was 12%, up from 10% in the prior year.

Ecommerce returns are generally higher than in-store purchases as it's much easier to ship the item back than to face a service desk associate who may challenge the transaction. Overall, Forrester estimates the flood of returned goods costs the retail industry about $20 billion per year, as items can be difficult to resell—often falling quickly out of fashion, favor or popularity—or liquidate via a 3PL or jobber.

Forrester retail analyst Sucharita Mulpuru said that "friction" in ecommerce returns—anything that makes the process more difficult or inconvenient—is a factor acting as a drag on ecommerce growth.

"When you have a marketplace transaction and the consumer has to return the item to the manufacturer that counts as friction in the return process," she said. "In that case the consumer probably doesn't have visibility into what happened with the return—there's no phone number to call to help manage it. That's one of the things ultimately holding back ecommerce."

The better retailers address this issue by becoming a "stopgap" in this situation, Mulpuru said, telling customers to try to reach the supplier first but offering to step in if they don't respond. "Amazon is very good about that."

Just as omnichannel practices like in-store pickup and ship from store are on the rise, many retailers focus on giving customers the option of returning online orders in store. Not only is this a consumer convenience, but having them in the store often leads to a use of the credit for another purchase.

In fact, the desire of consumers for this option is aligned closely with retailers' ability to deliver it. According to a 2014 study from Accenture, 42% of shoppers said they wanted to be able to bring online orders back to a store, and a greater number of retailers—49%—said they were able to do so.

This contrasts with a disconnect on the fulfillment side: Accenture found that 75% of consumers believed it was important to be able to schedule a delivery time, while only 34% of retailers allow this convenience.

Customer Experience Is King in Returns

As "wowing the customer" has become such an important factor in every facet of retail operations, returns are also certainly an important element in this equation. Companies are doing all they can to ensure that the returns process is as seamless and pain-free for the consumer as possible, adding features like tracking, label printing (or including a label with the item) and rapid issuance of credit.

In an increasingly omnichannel world, customers generally don't have a concept of one channel versus another. And so it goes with returns; they just know they bought it from your brand and need to send it back without a lot of hassle. So a lot of heavy lifting in returns goes into removing all the internal barriers to delivering on that customer expectation. While not every company may be able to deliver a Zappos-like experience—free returns within 365 days—they can go a long way toward delighting a customer who received an unwanted or damaged item.

Jerry Bellante, director of operations at Duluth Trading Co., said his company initiated a new fast-track return merchandise authorization (RMA) capability in 2014 to up its service game. The customer just has to go online, pull up the order and click what they want to return and why. As soon as Duluth Trading Co. receives confirmation via its return service provider that the item is in the postal stream, a credit or reshipment is ordered.

"It speeds up the return process tremendously," Bellante said. "During peak season when the volume is horrific, customers can get their refund very quickly, sometimes before we get the package in house."

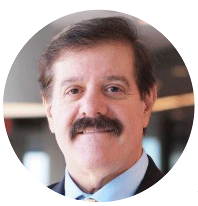
Curtis Greve, managing partner of reverse logistics consultancy Greve Davis, said while such a service is a nice feature, most consumers aren't concerned about being issued immediate credit for a return. "As long as it shows up on their next credit card bill, they don't seem to care if it's a day or a week," Greve said.

One challenge that can negatively affect the customer experience is getting returns back into available inventory quickly enough, especially if the item is in demand. For instance, if someone is shopping online for a popular sweater but sees that it's sold out she'll be disappointed and probably look elsewhere. That's why a new capability that is gaining interest among retailers is a "notify me" function. It lets a shopper know via email or text when an out-of-stock item becomes available, through either replenishment or returns, and gives them the option of reserving it. Thus, interest and demand is captured and the sale is saved.

Addressing Returns Fraud and Abuse

Techniques and processes put in place to thwart criminal activity around retailers' return policies continue to be put to the test, and with steadily improving retail sales, even more is on the line when it comes to losses from return fraud. According to the NRF survey, the industry lost an estimated $10.9 billion to return fraud in 2014.

The survey reported that an estimated $3.8 billion would be lost to return fraud in the 2014 holiday season alone, up a bit from $3.4 billion in the prior year. Overall, retailers polled estimate 5.5% of holiday returns are fraudulent, similar to last year's 5.8%.



"Today's sophisticated technology does well keeping criminals at arm's length but often isn't enough to completely stop the unethical practices of organized and individual retail fraud occurrences," said NRF vice president of loss prevention Bob Moraca. "Return fraud has become an unfortunate trend in retail thanks to thieves taking advantage of retailers' return policies to benefit from the cash or store credit they don't deserve."

According to the survey, 92.7% of respondents said they have experienced the return of stolen merchandise in the previous 12 months, down a bit from 94.8% in 2013. In a troubling sign, 78.2% said they experienced return fraud at the hands of organized retail crime groups, up significantly from 60.3% in 2013.

As more shoppers look to digital receipts for ease and convenience, retailers are seeing increasing instances of e-receipt return fraud, with 18.2% saying they had experienced it, up from 15.5% in 2013.

More retailers are instituting systems that monitor all return transactions and score them to determine the likelihood that fraud is occurring. If any unusual outliers or transaction events fall outside the normal range, an alert is issued and a fraud team assesses it. These teams also assess so-called habitual returners and call out any cases that cross the line into return abuse, with some companies opting to "fire" the worst offending customers.

Returns have a heavy impact on a consumer's purchase behavior. A 2014 UPS/comScore study found that when a retailer offered either free return shipping via a prepaid label or in-store return of online purchases, 82% of consumers said they were likely to purchase. Throw in a restocking fee, however, and that figure dropped to 33%.

For this reason, retailers have been offering more generous returns policies to entice shoppers. But this, of course, leads to increased instances of abuse, with customers doing things like ordering multiple sizes to try them all on.

Downing of Gardener's Supply said that while returns fraud has not been a major issue, the company has had instances of abuse.

"If a representative thinks a customer is abusing the returns policy, they will turn it over to a supervisor who will look at the history and make the determination if the customer is in fact abusing," she said. She added there have been a few instances over the years of such customers being "shut off."

Technology Solutions and Outsourcing

To combat the growth in returns and its attendant costs, retailers are instituting technology solutions that can help curb the influx. For instance, some systems can track returns by week, brand, and product size, enabling a retailer to identify and swap out a non-standard size chart that leads to misfits and more returns. Other systems can crunch data and conduct analysis that allows retailers to better allocate product regionally, thus reducing returns for things like wrong sizes.

Forrester's Mulpuru said there are few companies that don't outsource at least a portion of their returns process, due to

the cost and complexity of doing it all in house, and a tendency to have it become a resource drain without a payback.

"It's very onerous and there are lots of third-party solutions," she said. "Between hiring a vendor or 3PL or sending returns to an outlet or a jobber, there are a lot of different options, and there are more professional players offering it as service. As ecommerce returns continue to grow, retailers who handle them in house will find they need more full-time staff to focus on it, and that's probably not a cost-effective solution. So I suspect there will be more outsourcing providers supporting returns in the future."

Grieve said while Walmart and Macy's are two major retailers that continue to handle the bulk of their returns processes internally, they are by far the exception to the rule. The trend toward outsourcing has been in place for years and is growing, he said, for two primary reasons.

"First, most retailers don't have a good core competency in managing the returns process and systems," he said. "Second, as half their returns will probably be sold on the secondary market, they need someone with the systems and the buyer base who can effectively liquidate the merchandise."