The Results Group

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# THE HIDDEN CO$T$ OF REVERSE LOGISTICS

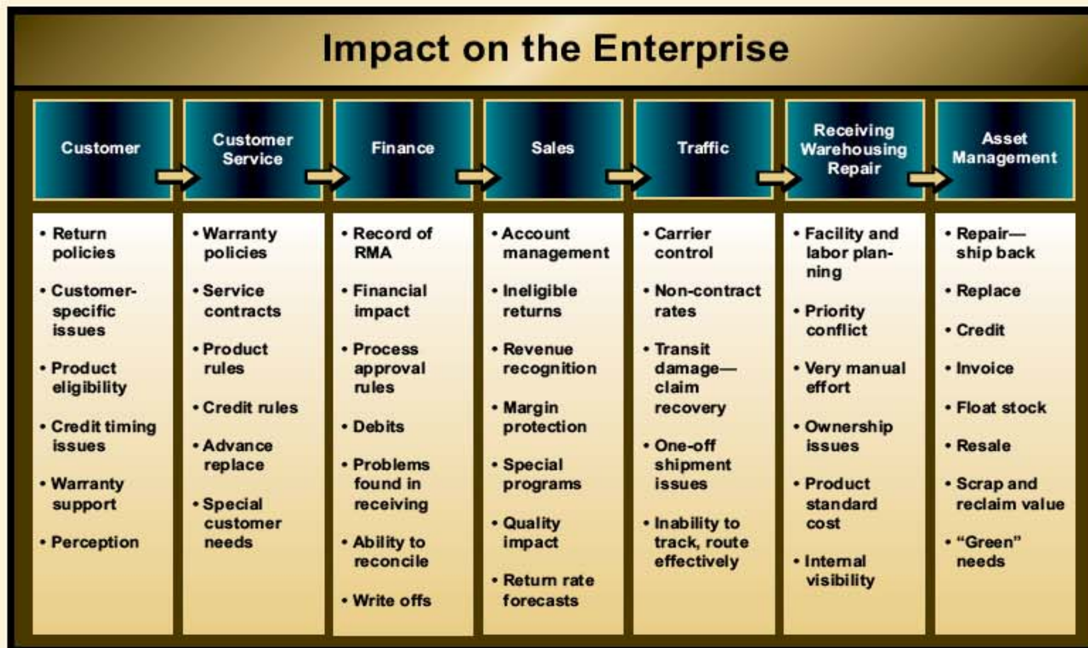
The need to manage returning product has always existed in businesses that produce and sell physical goods. This is typically referred to as "reverse logistics" or "returns management," and, until very recently, was most often defined as being post-sales service and support—focused on warranty and repair needs.

However, with continually-changing economic cycles and recent Sarbanes-Oxley legislation that makes C-level executives accountable for anything that impacts profits and financial statements, the covers are being lifted off this complex—and expensive—side of business.

This growing awareness has not been a surprise to those in organizations who have struggled to manage returns efficiently, working to reduce cost and trying to gather information about returns that they hoped was both valuable and needed by management. What has been surprising to them is how little the rest of the company, especially at the executive level, understands the amount of work involved and the corresponding cost to quickly and correctly process returning product.

Visibility to the total cost is understandably difficult when you realize that the costs for managing returns are buried in the daily workings of functions across the company. The chart below indicates some of the processing tasks, but the list is not exhaustive; any one of the functional managers could easily add more items to his or her list.

Although the term "returns" obviously applies to product coming back, companies focused on the service and support side are not



**Impact on the Enterprise**

| Customer | Customer Service | Finance | Sales | Traffic | Receiving Warehousing Repair | Asset Management |
|---|---|---|---|---|---|---|
| • Return policies | • Warranty policies | • Record of RMA | • Account management | • Carrier control | • Facility and labor planning | • Repair—ship back |
| • Customer-specific issues | • Service contracts | • Financial impact | • Ineligible returns | • Non-contract rates | • Priority conflict | • Replace |
| • Product eligibility | • Product rules | • Process approval rules | • Revenue recognition | • Transit damage—claim recovery | • Very manual effort | • Credit |
| • Credit timing issues | • Credit rules | • Debits | • Margin protection | • One-off shipment issues | • Ownership issues | • Invoice |
| • Warranty support | • Advance replace | • Problems found in receiving | • Special programs | • Inability to track, route effectively | • Product standard cost | • Float stock |
| • Perception | • Special customer needs | • Ability to reconcile | • Quality impact | | • Internal visibility | • Resale |
| | | • Write offs | • Return rate forecasts | | | • Scrap and reclaim value |
| | | | | | | • "Green" needs |

eBoomerang, Inc. 2005

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seeing the impact on their business from returns due to fulfillment errors, transit damage, buyer's remorse, or promotional and seasonal excess. Stock rotations coming back from channel partners are expected, and reserves may be in place to deal with the value of the product coming back, but rarely are budgets adjusted to deal with the cost of processing this new product and putting it back through the inventory and sales loop.

What is also not budgeted is the amount of manual effort involved in processing returns. Product that moved forward in box quantities, stacked neatly on pallets comes back as individual units, each one requiring handling, testing, remarking, repair, and other services, all at the individual unit level.

In the majority of companies, returns processing is still mostly manual even if robust supply chain, purchasing, and warehouse management systems are in place. These systems do not provide the efficiency and decision support that would reduce processing cost and cycle time, support the financial processing, and take care of the customer when he needs it most…when he has a problem.

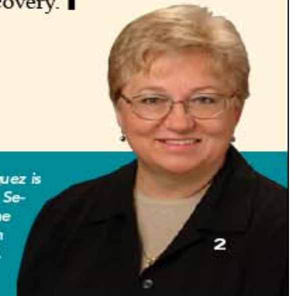
Call centers, or customer service teams, may take the information and respond to the immediate issue of approving a return. They may also capture some of the detail and make it available to the enterprise resource planning (ERP) system. Some warehouse and transportation systems also touch returns, but with the focus of capturing the data needed to optimize the main functions of managing warehouses or transportation functions. Very few systems provide decision support, processing optimization, best-case dispositioning, and financial processing.

Even if they do provide some of these functions, rarely is the processing based on customer relationships, product specifics, and program needs in a flexible environment that allows the rules and processing to change as easily and frequently as the business itself changes. The need to process returns has been around forever, and every company has found some way to deal with returns. Most of today's solutions are proprietary, inflexible, expensive, and outdated. And none of them capture the total cost of processing a return.

In most companies, there is no single, senior-level owner of all the return and customer satisfaction issues. Because costs are spread throughout a company, there is also no single budget for processing all returns. This dispersion hides the full cost and the impact on profitability. In 2004, Gartner research found that returns could have a 30 to 35% negative impact on profits. Most financial organizations do see the cost of reconciliation and write offs related to returns, but who in a company measures the impact on customer satisfaction, customer retention, and profitability when returns take weeks to process and credits are issued slowly and don't match customer expectations?

Recent focus group studies done by the University of Nevada in conjunction with the Reverse Logistics Executive Council (RLEC) have revealed an interesting phenomenon: in this day of commoditized products, when features, functions, and price are very similar, what differentiates brands is *service*. Of particular interest was their finding that a customer who had a problem that was handled to his full satisfaction was a more loyal customer than one who had not had a problem at all. The satisfied customer was more likely to buy the same brand the next time—because they knew what to expect if problems came up.

For companies that have begun to recognize the value of good returns management, the next challenge is to determine how to measure the impact, how to calculate the costs when they're hidden everywhere in the company, and how to build a business case that will support investing in the resources and solutions needed to really take care of customers, while protecting margins and accelerating asset recovery. ▌



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