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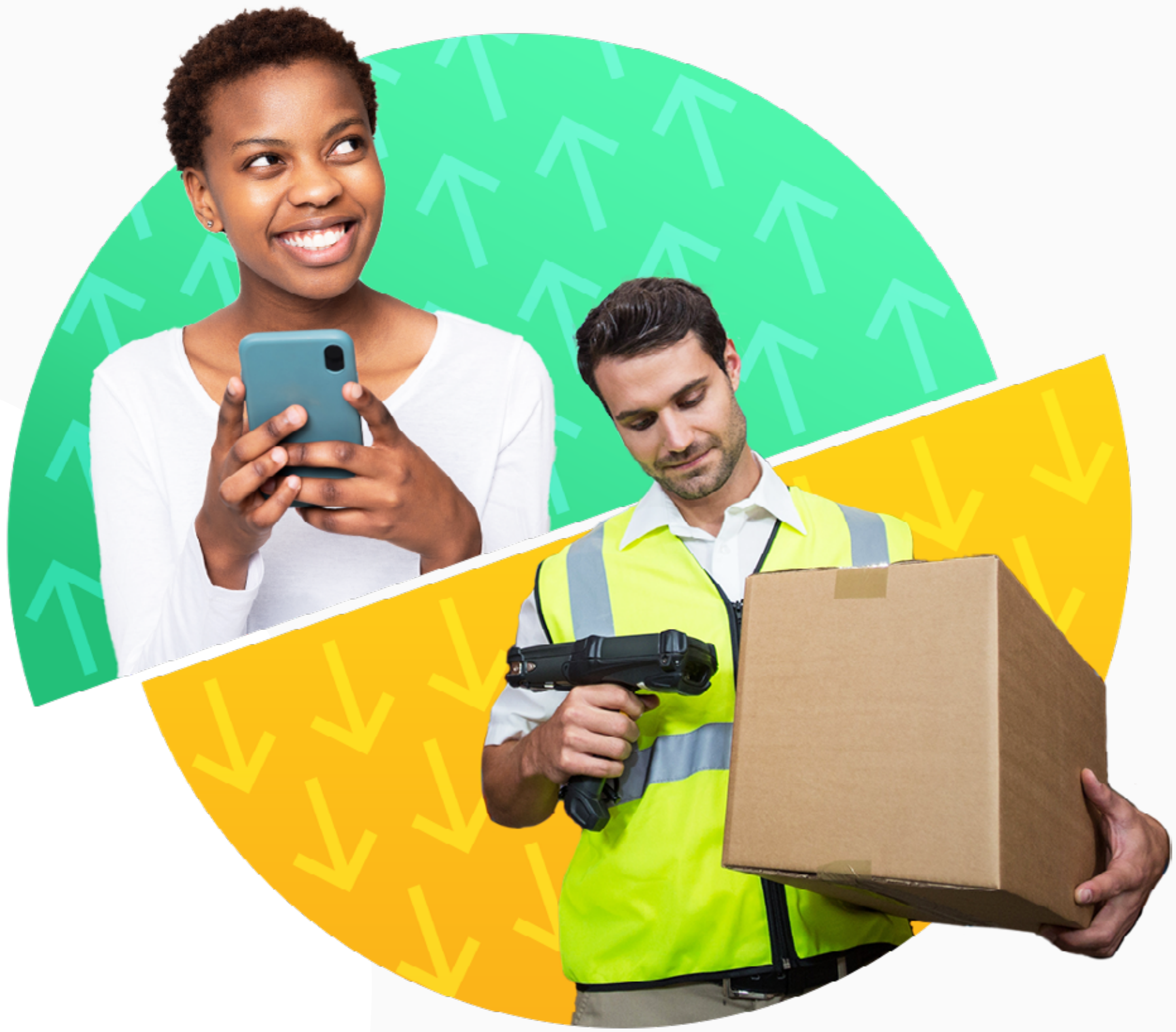


The Returns Dilemma

The Retailer's Secret to Avoiding the Cost-or-Revenue Trap

WHITE PAPER

Introduction

Over the last five years, many aspects of retail have changed — from the rise of digital shopping and increase of omnichannel fulfillment to today's ever-changing customer expectations. Returns are no exception to the pattern of change — what has changed most seems to be how savvy retailers are thinking about returns.

This white paper will examine how retailers & third-party logistics (3PLs) providers tackle one of the biggest dilemmas in retail and how to leverage returns as a competitive advantage for both top line growth and cutting unnecessary costs.

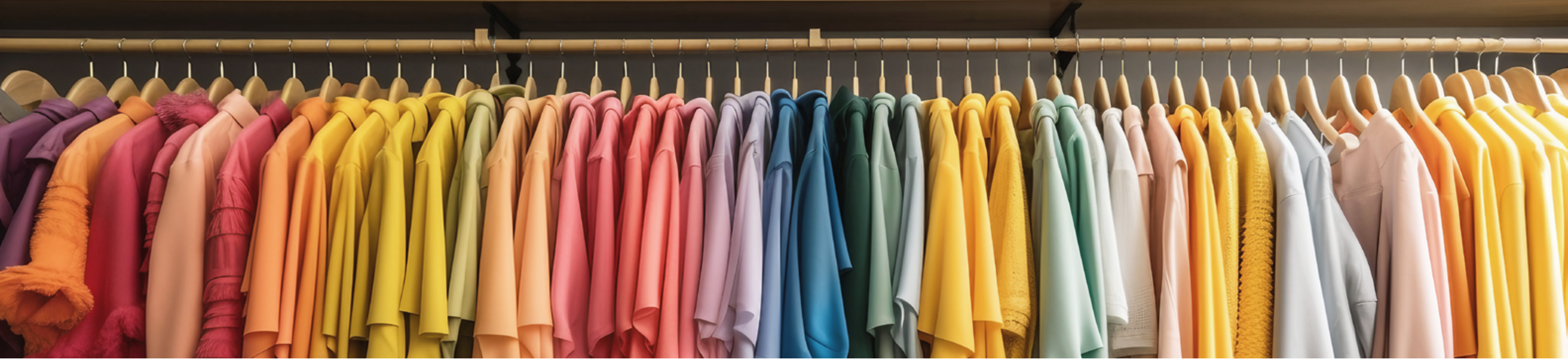
First, let's evaluate the market landscape.

There has been a major evolution of returns. **Five years ago, only 3% of retailers considered returns a priority**[1]. Most businesses consider returns a cost of doing business, rather than a strategic lever to pull.

Now more than a third of retail leaders view returns within their top three priorities[2] and understand it as complementary to acquisition and retention strategies.

Top Priorities for Retailers

2018	TODAY
1 **Omnichannel** (BOPIS, endless aisle)	1 **Growth/Expansion**
2 **Clienteling and personalization**	2 **Improving Customer Experience/CSAT Scores**
3 **Associate Enablement**	3 **Reducing Returns / Reducing Lost Sales from Returns**
4 **Store Experience** (new shopping formats, layouts)	4 **Acquiring New Customers**
5 **Email Capture**	5 **Increasing Customer Lifetime Value**



Why the paradigm shift with returns?

Ecommerce sales are projected to increase 55% between 2023 and 2027, and eCommerce returns are skyrocketing[3]. In fact, the average return rate is just over 20% and has risen 50% since 2020[4]. Of those returns, apparel has the highest returns rate[5]: **26% of clothing items purchased online are returned**[6].

While returns are a growing concern, so is the overall economic outlook.

> "The fashion market, excluding the luxury sector, will struggle to deliver significant growth in 2023. McKinsey analysis of fashion forecasts projects relatively slow sales growth of between –2 and +3 percent, weighed down by a contraction in the European market (expected to shrink between 1 and 4 percent). China and the United States are expected to fare better, growing between 2 and 7 percent and between 1 and 6 percent, respectively."[7]

Retailers burdened by the rising costs of returns are still forced to consider how their returns experience will impact their customer sentiment.

Always keen to focus on creating the ideal customer experience, retailers are increasingly adding additional payment options, expanding into new channels, and offering convenience options like buy now pay later (BNPL) — all of which rarely come without a price tag. Retailers are aware that a great CX impacts both customer acquisition and retention numbers, and drives revenue and growth for their organization. And with a recession looming and consumers pulling back on spending, it's more important than ever to keep the shoppers you win - and investing in CX pays off: **Superoffice found that 86% of buyers are willing to pay more for a great customer experience**[8].

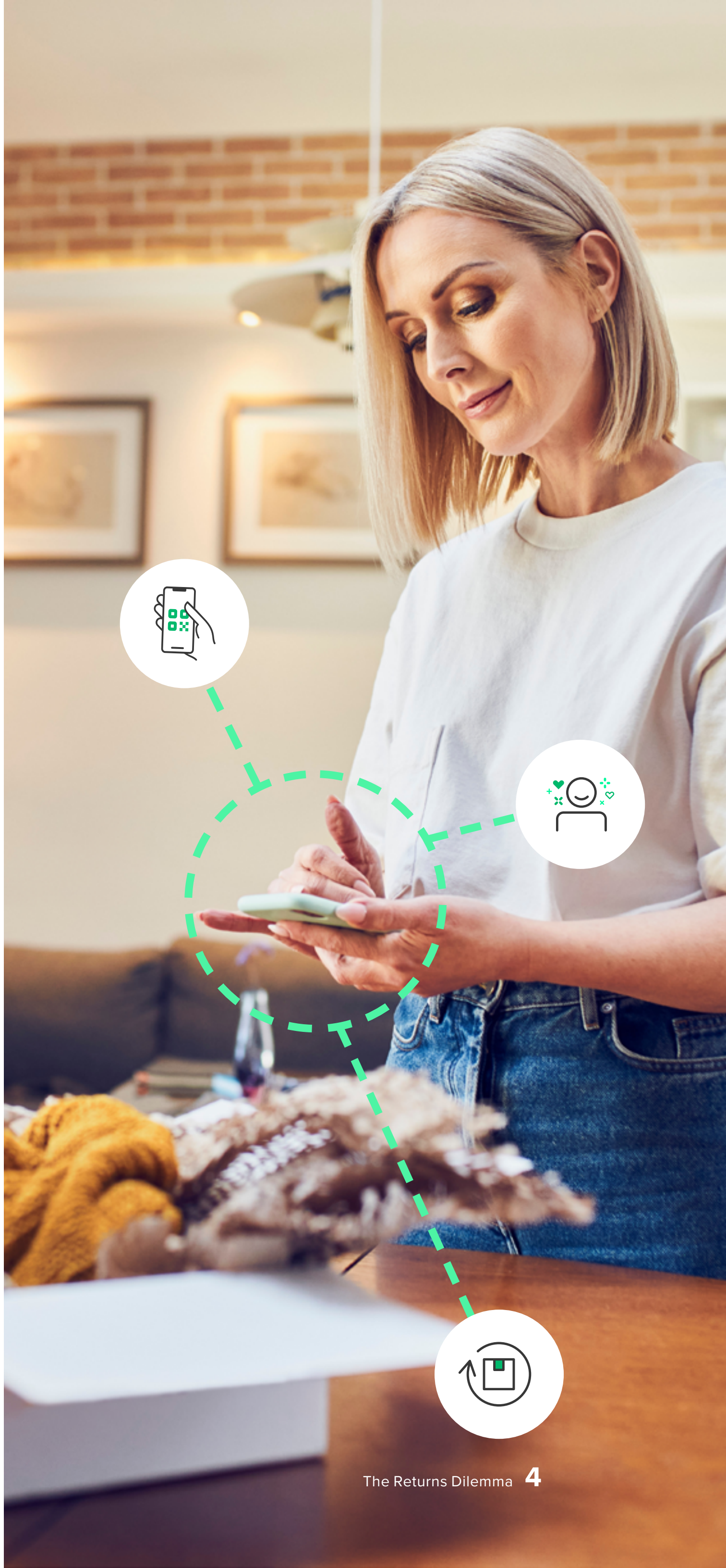
These challenging market conditions have seen retailers realizing that between rising costs and rising customer expectations, they are increasingly finding themselves between a rock and a hard place. Anything that can mitigate both problems at once is a powerful one — and returns can be one lever to pull.

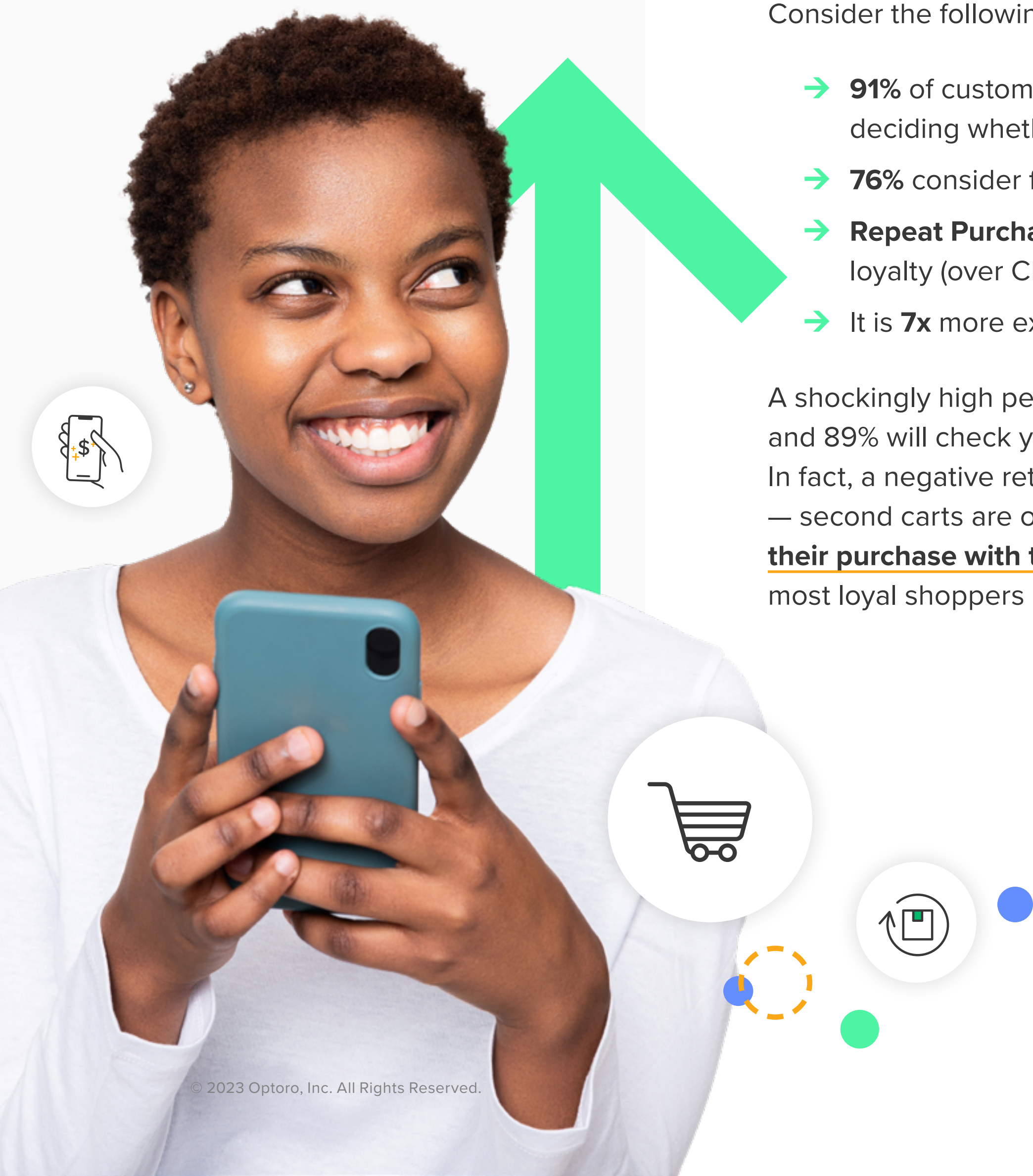
How Returns Impact the Cost-Growth Dilemma

The returns market is changing, as evidenced that between 2022 and 2023, **87% of retailers updated their returns policies**[9]. A 2023 Optoro study shows that returns have become a top priority for retailers. The why is important to understand: retailers see that returns touch all departments in their organization and offer insights into why certain products do well and others don't. Returns are a microcosm of a company's performance.

By understanding how each team within an organization views returns, retailers can unlock the ability to solve multiple problems at once: one team may be able to cut costs around returns processing while another can simultaneously improve customer loyalty — it simply depends how a retailer approaches the problem. As retailers optimize their omnichannel strategies and adjust to their post-pandemic normal, they are investing in data-rich solutions that allow them to address their top concerns — cost reduction and customer experience — by identifying redundancies and reducing fraud costs.

Returns can reflect both how customers interact with your brand as well as represent a chance to cut costs.





Can I Use Returns To Drive Growth?

The focus on driving revenue is centered around curating the best customer experience, and the returns lifecycle plays an integral role in how customers interact with your brand. Consider the following facts:

- **91%** of customers view a retailer's returns policy as an important factor in deciding whether or not to shop there[10]
- **76%** consider free returns when deciding to shop
- **Repeat Purchase Rates (RPR)** is viewed as most used method of measuring loyalty (over CLV, NPS, CES, CSAT etc.)[11]
- It is **7x** more expensive[12] to acquire a new customer than to keep an old one

A shockingly high percentage of shoppers will look elsewhere if an item is out of stock[13], and 89% will check your returns policy before choosing to shop with your brand again[14]. In fact, a negative returns experience is most likely to impact your most loyal customers — second carts are often larger than the first, and **up to 50% of shoppers will bracket their purchase with the intention of returning at least one item**[15]. This means that the most loyal shoppers are those who return the most.

Converting returns to exchanges

One way that retailers can keep their most loyal customers engaged is by encouraging a sale instead of a return. **Only 10% of retailers have already begun offering refunds in less than 24 hours**[16] in order to encourage their customers to shop again immediately. Some retailers are even beginning to incentivize shoppers to take action sooner by offering a time-bound bonus credit to apply to an exchange order. A return converted to an exchange prevents lost revenue, protects margins, and satisfies the customer.

Returns Channel Expansion

Additionally, many retailers are looking to make the returns experience as frictionless as possible by adding hyper-convenient ways to return, such as packageless, labeless drop-offs and even home pickup returns where shoppers can simply place an item outside their door for porch pickup. In fact, **40% of the retailers surveyed by Optoro had added drop off locations in the past year**[17]. Consumers, for better or worse, expect 'the Amazon experience', where returns are free and frictionless.

Does it Work?

Investing in returns technology only makes sense if retailers receive a tangible return on their investment — and the data shows that meeting customer expectations and investing in customer loyalty does indeed drive revenue.

Research shows that **existing customers are 50% more likely to try new products, and 31% more likely to spend more compared to new customers**[18]. In fact, a Bain & Company and Harvard Business School report showed that increasing customer retention rates by 5% increases profits by 25-95%[19].

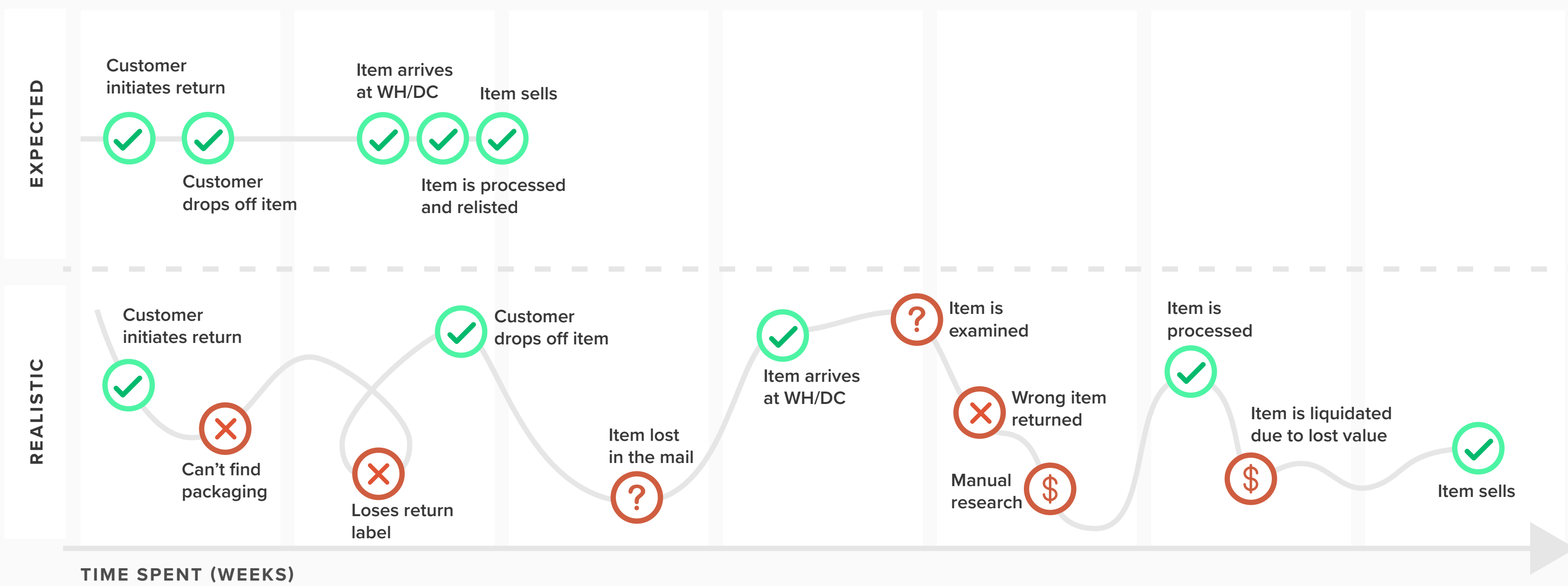
Can Returns *Actually* Reduce Costs?

In a 2023 Optoro study, the majority of retailers state that it **costs between 20-39% of an item's price to process it as a return**[20]. With a recession looming on the horizon, experts predict that more retailers will be focused on reducing both the cost and quantity of returns.

Yet Gartner recently found that **69% of companies don't understand the true cost of returns**[21]. In fact, less than 20% of retailers have clearly defined metrics to measure their returns performance[22].

Part of reducing the costs of returns is understanding what goes into them from an organizational perspective. Often, operations teams think of returns in terms of labor charges and unit per hour (UPH) value, but there are latent costs that often aren't considered when it comes to the returns lifecycle. **For example:**

The Returns Lifecycle



Costs Retailers Consider

- **Transportation costs**
  - "Supply chains remain disrupted from the COVID-19 pandemic, elevating the need to invest in faster and geographically closer manufacturing systems."
- **Overall Unit Cost**
  - Returns are 20-39% of unit cost
- **Relative Costs**
  - The overall number of returns being made have gone up

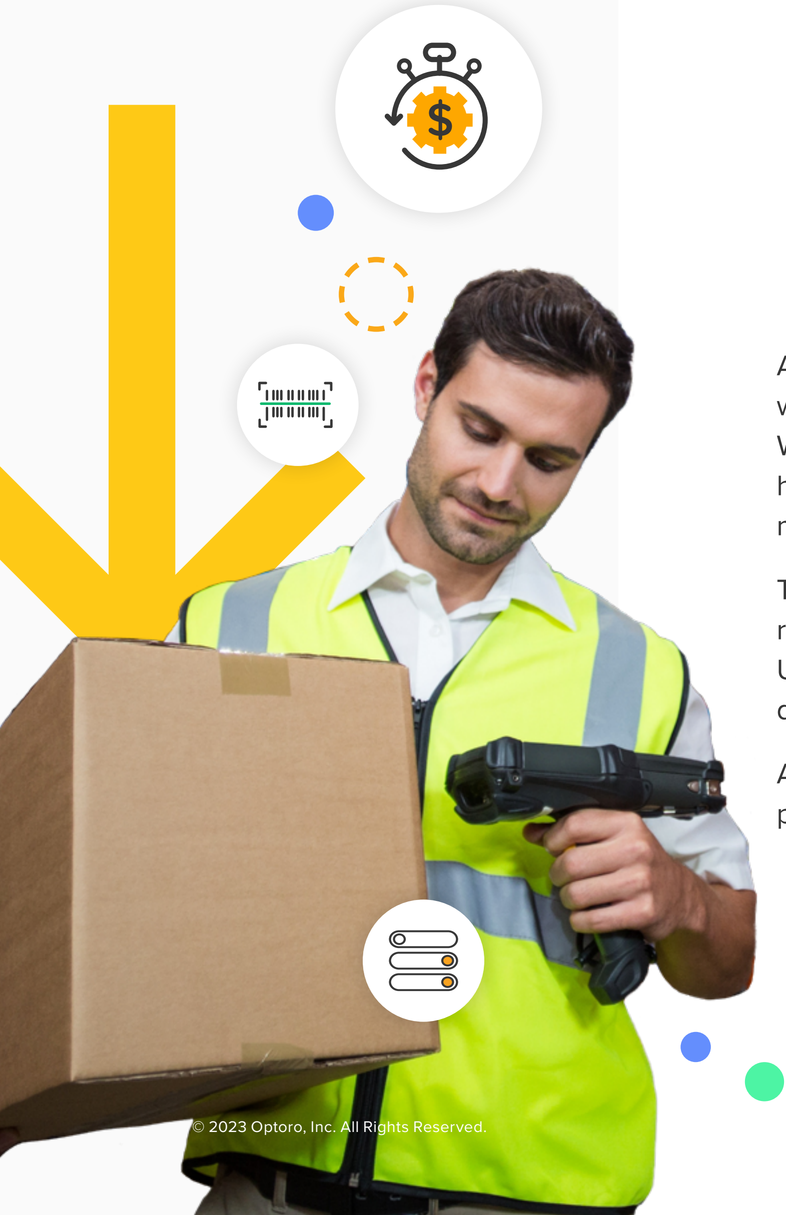
Optoro polled leading retailers in the United States and found that their top returns concerns were[23]:

1. **Time to restock**
2. **Backlogs during peak**
3. **Training difficulties**

Latent Cost of Returns

- **Lost sales due to stockouts, when a sellable item may have recently been returned**
- **Seasonal Losses**
  - 75-95%[24] of apparel could be returned to stock, however:
  - 10%[25] of online returns are incinerated or donated because the cost of holding them gets too high
- **Holding Costs**
  - In many retail businesses inventory is one of the largest expenses, so not optimizing the returns lifecycle can be costly
  - Liquidating can be better than holding an item, particularly if the item is seasonal
- **Unexpected Transportation Costs**
  - Transportation costs are often based on speed to refund/customer convenience, leaving retailers paying for single parcel shipments rather than less expensive consolidated shipments.
- **Shrink**
  - The dollar value of returns lost in the mail, not returned, or categorized incorrectly and left unsold

Reducing the costs associated with returns is a hydra with many heads, and there are many approaches, from creating strict returns policies to discourage or decrease returns, to outsourcing returns processing. Increasingly, however, retailers are turning to technology as a way to reduce returns costs without sacrificing CX.



With modern returns software, retailers can:

- Route fast-moving SKUs to their most profitable node
- Route seasonal products to their right geographical location
- Flag “not likely to sell” products to liquidate faster
- Automate dispositioning of returns to reduce labor costs
- Consolidate returns shipments to reduce transportation costs
- Implement dropshipping

All of these unique scenarios fall under **“reverse order orchestration”** functionality where retailers can configure routing logic based on unique or preferred business rules. While order orchestration is often referenced in the forward logistics of understanding how and where to best route orders to ship to customers, only modern returns management software gives retailers the same cost-efficiencies for reverse logistics.

These cost efficiencies represent the greatest opportunity for retailers to reduce their returns costs — by dropping shipping costs, decreasing labor costs, and increasing UPH while simultaneously getting items back into stock faster so customers aren’t disappointed by items being out of stock.

As more retailers discuss returns, whether from a customer experience or cost saving perspective, there are certain questions that come up every time.

The FAQ’s of Returns

Returns are a headache...can't I just get rid of them?

Answer: Yes, and No.

Reducing returns is an admirable goal and one that most retailers have considered — however, unfortunately, returns are an evergreen challenge. There are certainly dials to turn to reduce preventable returns (clear product information, try before you buy, better photography, creative “sizing” options, augmented reality, etc.). However, there are always going to be unpreventable returns.

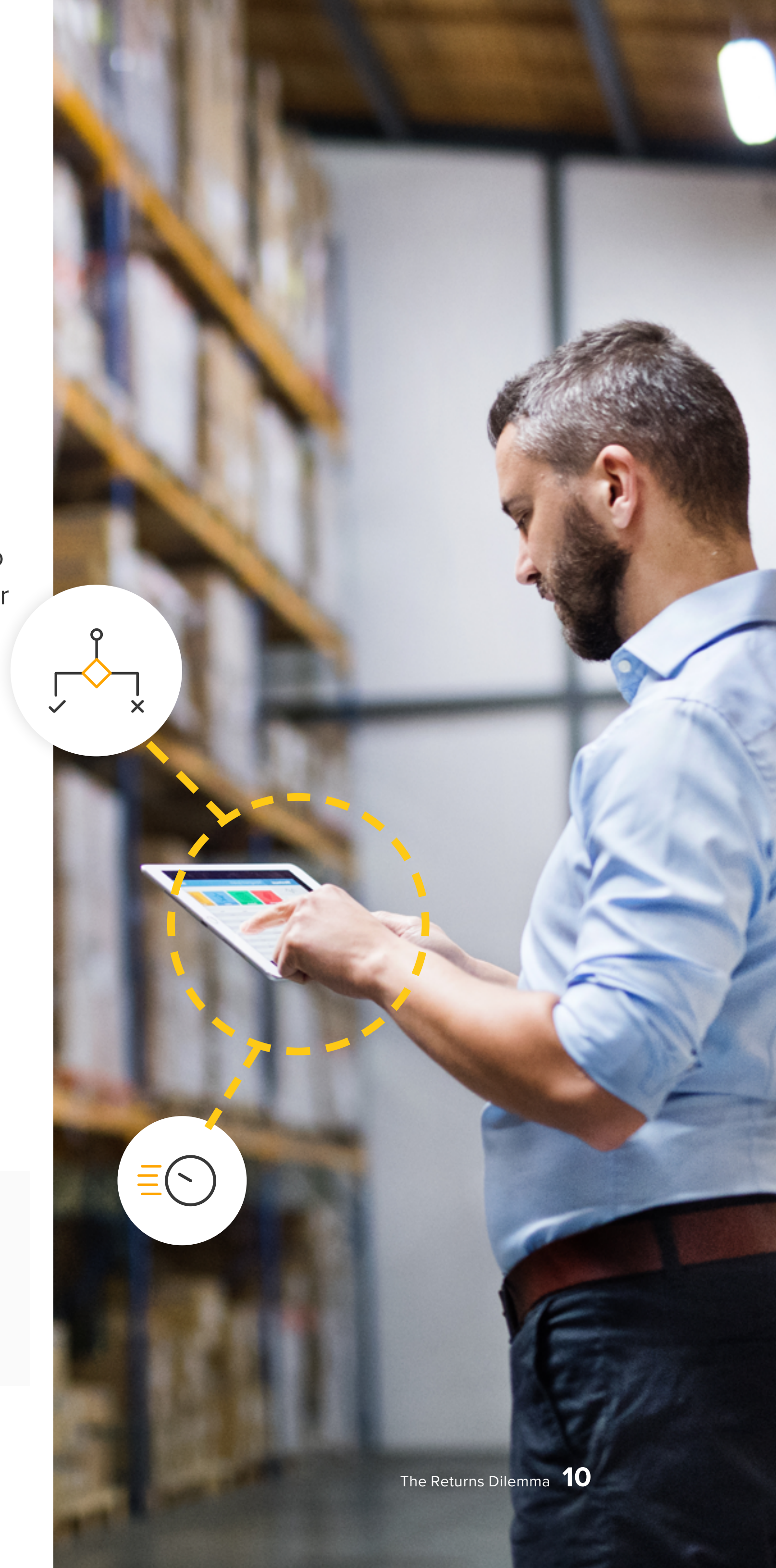
If retailers don’t consider returns as a critical part of their CX, and a shopper has a bad experience, you risk losing out on repeat (profitable) business.

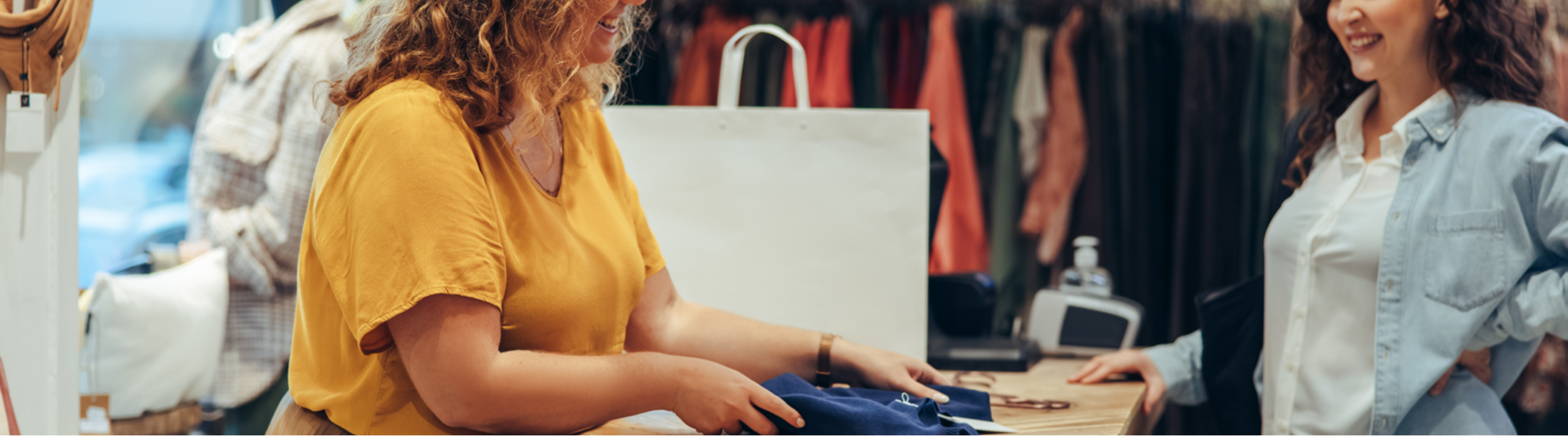
Difficult returns processes lead to consumers being less likely to return an item in a timely manner — which means:

- **Time to resale is elongated**
- **Forced liquidation of seasonal items (rather than resale)**
- **Reduced shopper repurchase rates due to unfriendly/unclear returns policies**

Instead of focusing on eliminating returns entirely, invest in solutions that reduce unnecessary returns while optimizing the returns lifecycle for the unavoidable ones.

TIP: Select a holistic returns software that provides flexibility around peak season (when 77% of customers plan to return at least one gift[26]) that reduces transportation costs.





If I can't reduce returns, should I charge for them to reduce my costs?

Charging for returns is a highly debated topic in retail. The massive spike in ecommerce sales over the last five years has led to a number of retailers like Amazon to Nordstrom to reevaluate their returns policies and consider whether or not they should charge for returns[27].

Companies like Zara, Foot Locker, JCPenney, Kohl's started charging for returns in the last 12 months[28].

At first glance, charging for returns may seem like a viable solution...the challenge is how it impacts the customer experience. Shoppers often evaluate a retailer's returns policy and can be more unlikely to repurchase if they don't have a good returns experience. In fact, **76% of customers say free returns are a deciding factor**[29].

If you are looking for alternatives, consider some creative options to address the cost of returns without charging, such as:

- **Offer free returns to loyalty members.** This incentivizes shoppers to join your loyalty program, and open up additional promotional opportunities.
- **Encourage in-store returns if you have brick-and-mortar stores.** This gets foot traffic back at the store, and a chance to recover the sale through another enticing item.
- **Leverage third-party drop off locations** like Staples where shipments can be consolidated to realize significant cost savings without damaging the customer experience[30].
- **Offer a "bonus" credit for a return** that may entice the shopper to exchange the return for another item in your store. (i.e. $10 extra to spend)

With returns, convenience often leads to speed — getting product back faster and increasing the likelihood of a repeat purchase in the future.

How do I combat fraud in my returns?

Customers want instant refunds and easy exchanges, and retailers don't want to lose sales to fraud.

Striking a balance between enabling your customers to immediately repurchase on your website while protecting against fraud is a delicate dance. There are a variety of ways to combat fraud, but decisively, the most efficient way to do so while also offering your customers the ability to exchange and extending customer keep, is to invest in a third party solution that takes on the risk entirely.

Retailers taking on the challenge themselves are investing in behavioral pattern software to determine which customers are safe to offer refunds to and often are removing customer-loyalty-boosting features like customer keep in order to remove any potential incentive for customers to cheat.

Other options include forcing customers to put down a credit card to order a new item for an exchange, which will be charged if the original item is not received back, or implementing strict time limits for when an item can be returned. Retailers can charge re-stocking fee and require proof of purchase, or not offering refunds at all until the item has been received back in a warehouse.

Most retailers don't want to have to devote a significant chunk of their IT department to fraud prevention, though, and are choosing to go with a third party vendor who will insulate them from any fraud risks while allowing them to offer the bells and whistles that keep their customers engaged — instant refunds to encourage immediate repurchasing, customers keep, and easy exchanges.

Can't my WMS/OMS/ERP manage my returns?

Most retail systems like warehouse or order management systems have some basic functionality level for returns. However, many of these systems put the pressure on front-end customer-facing systems to initiate returns.

Additionally, none of the systems were purpose built to solve the nuances of returns, so while they can facilitate a return, they often lack the robust feature set that helps speed up the returns process (read: higher UPH and faster time to restock).

How to Revamp Your Returns Management Strategy

Now that we have uncovered the big dilemma in retail, how do you build a plan in which you don't have to choose between reducing costs or driving revenue? How can a modern returns management system help you choose both?

Here are some items to consider when building the ideal returns management strategy.

Identify key stakeholders (internal & external)

Identify who owns what part of the process — most commonly, returns is not a one-department problem. Figure out who is responsible for each part of your returns lifecycle and assemble them into a dream team.

Identify who owns what, specifically

In order to identify best practices, your team needs to identify what metrics your organization is using to measure success. Does the digital team own repeat purchase rates and customer lifetime value KPIs? What goes into those? Does the operations team measure transportation costs? Who calculates losses on seasonal items?

Identify key metrics and KPIs — here are the most commonly used ones:

- Number of returns per month, or year
- Units Per Hour (receiving, picking, shipping)
- Customer service hours spent on returns
- Repeat Purchase Rate
- Customer Satisfaction (CSAT)
- Customer Lifetime Value (CLV)
- Seasonal Losses
- % Donated or Destroyed
- Sustainability Goals (tax credits, carbon reduction, etc.)

Identify your organization's long-term objectives for returns

We know, this is easier said than done — but a helpful way of framing this question is to think of where returns fits into your organization's overall strategic plan (hint: returns should fit into your organization's overall strategic plan somewhere). Another factor to consider here is the impact of social media — returns are often where companies go viral, often for the wrong reasons.

Identify what applications within your technology stack involve returns

- What integration(s) might be/are necessary?
- What data can be leveraged to impact systems upstream like your ecommerce storefront?
- What data can be leveraged to understand return reasons to mitigate unnecessary returns?

Identify Gaps

What information are you missing? **Common examples of missing information include:**

- Most common returns reasons so problems can be investigated
- Shrink rate
- Peak season comparative statistics — how much more does peak season cost, and why?

Consider Potential Solutions

Retailers can choose to solve their returns problem by building an in-house solution, buying a piecemeal returns solution that addresses different areas (i.e. forward tracking software, customer portal, 3PL), or turning to a returns lifecycle management solution.

Returns lifecycle management solutions integrate smoothly with existing OMS systems and offer visibility into every aspect of a return: why your customers are returning it, where it is as it is shipped, and how much it is costing you to process it. They also have the ability to relist and dropship your items within 24 hours of them arriving in your warehouse so that seasonal items are sent on to the people who want it most...your customers (rather than liquidators).

These solutions strike a balance between driving revenue by offering your customers an excellent front end experience with instant refunds and exchanges, while absorbing any fraud risks. On the back end they allow retailers to save significantly on costs with 3x higher UPH rates due to automated processing, and are able to slash transportation costs with consolidated shipping.

Retailers don’t have to choose between growing revenue and cutting costs when it comes to returns.

Optoro is the leading provider of returns technology for retailers and brands, using data and real-time decision making to make returns better for customers, retailers, and the planet. Retailers and brands—including Gap, Tuckernuck, IKEA, and Staples—trust Optoro's solution to make returns a strategic advantage for their business and enable sustainability initiatives across their supply chain.

Talk to one of our returns experts

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