

THE GROWING DILEMMA OF FREE RETURNS

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Much has been written about the acceleration in e-commerce revenue driven by COVID-19. For Q3 2020, e-commerce sales in the United States were \$200B, up 37% year-over-year. This represents 14% of total retail sales⁽¹⁾. While e-commerce has helped drive growth for retailers with an online presence, those same beneficiaries must now shift their focus to the massive influx of returns they will be forced to reckon with in the near future.

RETURNS ALREADY POSE A CHALLENGE FOR RETAILERS:

- Retailers lose an estimated 1/3 of their revenue to returns⁽²⁾
- Ease of shipping return and cost of return are the #2 and #3 most important factors for consumers when deciding from which retailer to make a purchase (#1 is free forward logistics shipping)⁽³⁾
- Over the next 5 years, as much as 400 million square feet of additional warehouse space will be needed in the U.S. to handle returns at the current volumes⁽⁴⁾

The problem will undoubtedly get worse as e-commerce growth accelerates. Return models will need to evolve to accommodate this unprecedented digital growth. Thankfully, technology can help, and with additional investment and focus on returns, retailers and brands can conquer the returns dilemma. Figure 1 illustrates this concept.

Figure 1 - The Free Returns Dilemma



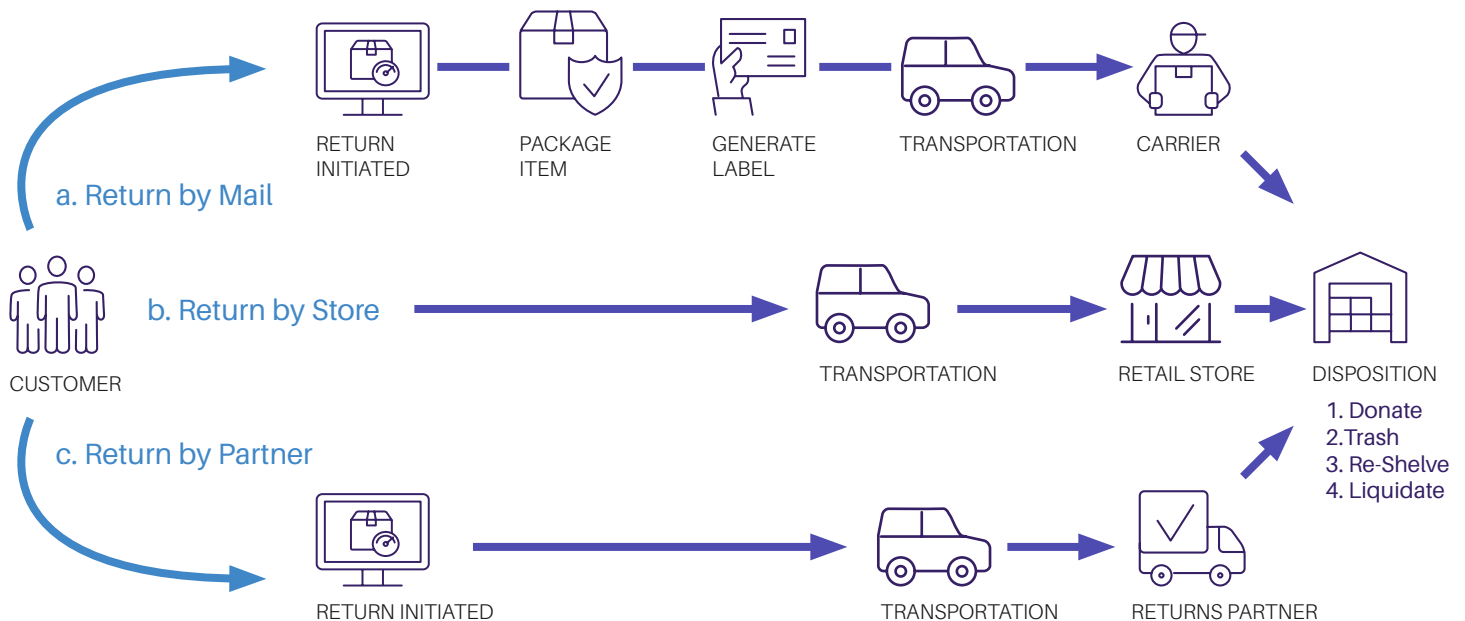
This paper aims to help retailers, brands and investors better understand the free returns dilemma by analyzing the following:

- 1** RETURNS PROCESS
- 2** TECHNOLOGY BUILDING BLOCKS
- 3** COST-BENEFIT ANALYSIS
- 4** ENVIRONMENTAL IMPLICATIONS

1. RETURNS PROCESS

Offering customers different options to return an item enhances the customer experience and allows for better alignment of the cost and benefits of returns versus simply offering free returns. Figure 2 illustrates the various return options for consumers.

Figure 2 - Returns Options




Return by Mail option offers the customer a convenient way to send back an item. This option is commonly offered for free, with brands and retailers bearing the shipping cost. Customers are responsible for printing the label, packaging the good and transferring to a carrier (e.g., FedEx, UPS, etc.). **Return by Store** comes at a low cost to the retailer but creates an inconvenient return trip for the consumer. **Return by Partner Network** is a hybrid model where brick and mortar locations serve as drop-off points for a variety of brands, driving increased foot traffic into the store. It also gives the consumer more drop off locations than Return by Store and immediate return credit for in-store purchases. Two examples:

- In October, Happy Returns, a leading reverse logistics provider, partnered with FedEx to offer in-person returns at more than 2,000 FedEx Office locations nationwide for Happy Returns’ retail partners. FedEx is leveraging Happy Returns’ technology to aggregate box-free returns into one shipment that is then sorted, processed and returned to each individual merchant.
- Amazon rolled out its Amazon Returns program in 2019 by offering free returns, without a box or label, at over 1,100 Kohl’s stores nationwide.

Figure 3 on the next page illustrates the trade-offs of each model; highlighting some of the challenges of free Return by Mail versus other models.

Figure 3 - Return Option Trade-Offs

RETURN TYPE		RETAILER COST	CUSTOMER CONVENIENCE	CONSUMER REFUND
 MAIL STORE PARTNER NETWORK	MAIL	Expensive	Convenient	Delayed
	STORE	Inexpensive	Less Convenient	Immediate
	PARTNER NETWORK	Moderate	Convenient	Immediate

2. TECHNOLOGY BUILDING BLOCKS

Technology is an integral part of the returns process. It can help flatten the cost curve of returns and allow return policies/options to be leveraged as a competitive advantage.

Below are key factors that are important to the return logistics technology stack:

- a. **Disposition** – quick and accurate determination of best options for returns received
- b. **Drop-off connectivity** – connect to Partner Network to offer many return locations
- c. **Integration** – connect seamlessly to e-commerce, third-party logistics providers, order management, warehouse management and carriers
- d. **Omnichannel capabilities** – offer e-commerce and in-store return options
- e. **Carrier selection** – offer carrier options and print labels for returns
- f. **Return tracking** – visibility into return status and refund timing
- g. **Monetization options** – opportunity to create optimal value from a returned item

According to Fara Alexander, Director of Brand Management at goTRG, “An accurate process to determine the value of a returned item is growing increasingly more important. **Dynamic disposition software is the best way** to determine how to extract the maximum value from a returned item.”

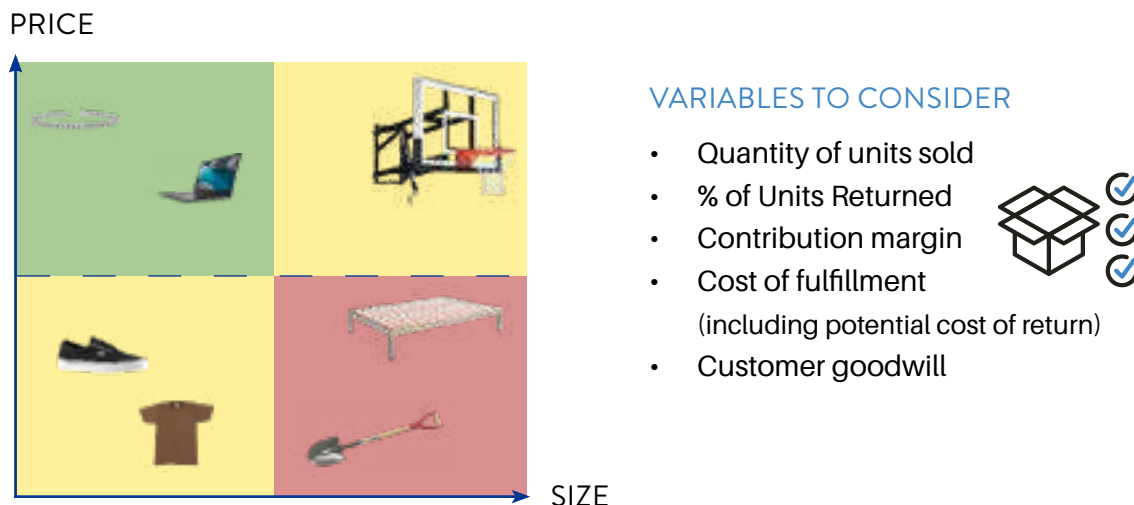
Additionally, according to David Sobie, CEO & Founder of Happy Returns, “A convenient and **accessible network of locations** where consumers can return box free for an immediate refund or exchange is critical for retailers and brands to optimize their returns offering.”

3. COST-BENEFIT ANALYSIS

There is an important trade-off for companies to consider when deciding which return options to offer: does the increase in sales outweigh the decrease in per unit profitability? By offering free returns, more units will be sold, however, the profitability of each unit will decrease driven by the absorption of return costs. For brands and retailers, the optimal decision depends on the type of product – specifically, the price (and implied contribution margin) and the size (logistics complexity) – as both will have implications on the potential to derive value from the returned item.

Figure 4 on the following page illustrates this analysis.

Figure 4 - Cost-Benefit Matrix



As an example, offering free return shipping for a shovel, a product with low value, does not make sense because the cost of the return exceeds the value created in restocking and reselling it.

4. ENVIRONMENTAL IMPACT

Aside from the economic factors, there is an important societal component that must be considered by retailers and consumers alike – the environmental impact. What consumers do not realize is that many of the goods they return are not resold. Whether due to damages, logistical inefficiencies or items just going out of style, many of these goods end up in a landfill.

- Approximately five billion pounds of returned goods are sent to landfills annually in the United States⁽⁵⁾
- 15 million tons of carbon emissions are generated by returns in the United States per year⁽⁵⁾
- Most brands and retailers use single-use plastic shipping materials that are non-recyclable⁽⁵⁾

ACCORDING TO A RECENT MCKINSEY SURVEY, 63% OF CONSUMERS SAID ENVIRONMENTAL IMPACT IS A KEY FACTOR IN MAKING PURCHASING DECISIONS.⁽⁶⁾

Traveling half-way across the country and back, only to be deemed unfit for resale and sent to a landfill is not an atypical journey. Purpose-driven businesses and brands have an opportunity to attract consumers as sustainability is an increasingly important criteria for consumers when making a purchasing decision. Both retailers and consumers should consider the role they each play in the larger supply chain ecosystem when considering a returns method.

CONCLUSION

With the accelerating growth of e-commerce, the challenge of returns will only worsen. Retailers and brands should increase focus on offering diverse, efficient return options and consider technology partners to optimize the trade-off of free returns. Technology companies and investors should view the challenge of returns as essential to the future of commerce and look to deploy capital into companies that are driving innovation in this often overlooked, but mission critical, part of the supply chain.

PJ SOLOMON's Software & Disruptive Technologies and Consumer Retail teams have deep industry expertise in supply chain & logistics and retail & commerce technologies. PJ SOLOMON is available to discuss technology partnerships, M&A and investment alternatives in return logistics.

1 - https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

2 - <https://www.voguebusiness.com/consumers/returns-rising-costs-retail-environmental>

3 - <https://ecommerceguide.com/ecommerce-statistics/>

4 - <https://www.cnbc.com/2020/12/07/america-needs-more-warehouses-to-handle-record-holiday-returns-cbre.html>

5 - <https://www.voguebusiness.com/consumers/returns-rising-costs-retail-environmental>

6 - <https://www.mckinsey.com/industries/retail/our-insights/survey-consumer-sentiment-on-sustainability-in-fashion>

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