

Special Report

Reversing Inventory Management

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A customer walks into a store to return a steam iron. He later returns three more because after waiting 20 minutes the irons failed to heat. On the fourth return a clerk notices that the irons automatically shut-off after five minutes if they are not used.

It's no joke. Bernie Fidler remembers the incident from his days as an assistant vice president of finance and service at Service Merchandise, a former catalogue showroom chain.

Now a vice president with Stuart and Associates, Franklin, Tennessee, Fidler said the same thing happened with cordless phones and digital cameras. Customers returned products by the score not because they were defective, but because, in the latter case people traded up for newer models. In the former, consumers didn't realize the phones needed to be charged.

Returns are a cost factor in most industries, but especially so in consumer electronics. According to the Consumer Electronics Association, returned goods cost the industry \$10 billion annually, and many of those goods are in perfect working order. According to the Ease-of-Use/PC Quality Roundtable Group, a group of communications and IT equipment retailers and manufacturers that includes Philips, Intel, Dell, Microsoft, Hewlett-Packard and Comp USA, seventy percent of returned consumer electronics have no defects.

Once a narrow niche in the logistics world, reverse logistics has become an industry in its own right; one complete with the strategies and analyses that mark the mainstream logistics business. It is so big, in fact, that many companies are looking at the complexity and scope of the reverse logistics industry and doing their best to cut it back down to size.

Reverse logistics, they say, may have gotten about as good as logistics gets. Now, the goal for a growing number of companies that have built efficient reverse pipelines is to keep returns from entering those networks in the first place through technologies such as electronic registration at the point of sale. In other words, it's reverse inventory management.

At the root of the returns problem is what Tony Sciarotta, director for returns management at Philips Consumer Electronics, described as an "out-of-control" culture of entitlement in which retailers offer open-ended return policies to increase sales.

That, says Sciarotta, encourages customers to return goods at any time, for any reason, with or without a receipt. Retailers are flooded with returns. They, in turn, flood manufacturers'

supply chains with returns that are out of warranty and/or obsolete.

Sciarotta said there are widespread problems with unauthorized and/or fraudulent returns of goods that are stolen, outside the warranty period, purchased elsewhere or exchanged for newer models.

Many retailers are tightening up return policies and are weeding out return-prone customers.

Last month, The Wall Street Journal reported that Best Buy, with over 780 retail stores in the United States and Canada, has segmented customers into "angels" and "devils" and is trying to shed 100 million annual customer visits, or 20 percent of the total. Among other reasons, "devil" customers apply for rebates and then return the items, which are then repurchased at discounts. Best Buy did not return calls seeking comment.

The ability to do that is an offshoot of the increasingly sophisticated supply chain management software that retailers and manufacturers use to manage their inventories.

Richard Hastings, an analyst with Bernard Sands, a credit rating company, said new point-of-sale software is providing detailed information that allows companies to cast long-neglected expense categories such as returns in a new light.

"There seems to be a general trend not in managing returns, but the people associated with returns," he said. "For some retailers growth has slowed, so if you want to manage profits you have to manage returns."

Companies are motivated to reduce returns because their costs, which involve sorting, packaging, transportation, inspection, testing, restocking, warranty management and reconciliation, are enormous.

Dale Rogers, chairman of the Reverse Logistics Executive Council and director of the Center for Logistics Management at the University of Nevada-Reno, said that inventory carrying costs are almost one-hundred percent at the end of a product life cycle, and nowhere does obsolescence occur more often than in consumer electronics.

Wal-Mart processes around \$6 billion in annual returns, with 17,000 trailers dedicated to the company's reverse logistics network, according to Chuck Johnston, general manager of the Wal-Mart Stores returns center in Bentonville, Arkansas. He spoke in September at a Chargebacks Management Conference in Chicago sponsored by CSM Communications, a wholly owned affiliate of Bernard Sands.

Citing data from the Ease-of-Use/PC Quality Roundtable Group, CSM reported that no defects are found on seventy-nine percent of returned PCs; that PC returns are around \$1.5 billion per year, or close to \$95 per PC sold, and that wireless return rates are around thirty-five percent.

Gailen Vick, president of Reverse Logistics Trends, an association and data clearinghouse for manufacturers and 3PLs, said that the issue of reducing returns before they get into reverse channels is the top concern of the industry.

"It is the hot topic and has been for eons," he said. "The difference is that CFOs have just figured it out."

Sean Wargo, director of industry analysis for the CEA, said that given the annual \$10 billion price tag — a figure that represents a 7 percent aggregate annual return rate for all consumer electronics sold — returns are always near the top of the industry's agenda. According to CEA research, half of all returns are due to product breakage while the other half are correlated to a lack of information about the product or other reasons unrelated to product quality.

"Returns are a big deal for the industry," said Wargo. "Manufacturers love to see customers satisfied and will do whatever they can to reduce returns."

To reduce fraudulent and/or improper returns, Sciarotta turned to SiRAS.com, a wholly owned subsidiary of Nintendo of America.

In the early 1990s, Nintendo began developing point-of-sale electronic registration technology to reduce fraudulent and/or unwarranted returns of its video games systems. POS ER, a patented business methodology, scans product UPC numbers at the cash register. If the UPC number has been designated for registration by the manufacturer, a prompt alerts the salesperson to scan the product's serial number, store number and the date and time of the transaction. The data is transmitted to the SiRAS national database via EDI or XML. If the customer returns that product, the serial number is scanned and the POS registry divulges the sales history and the disposition of the return.

SiRAS.com president Peter Junger said that the POS ER methodology was developed in response to the introduction of a second-generation Nintendo video game in the early 1990s when consumers began returning the original product for the newer model.

"Nintendo was selling every unit they could make, but they were not making any money," he said.

The system was rolled out at Wal-Mart in 1996 to track Nintendo returns. Prior to that, return rates were between seven and ten percent, Junger said. Today, Nintendo return rates are under two percent.

Junger said SiRAS has spent millions in the last few years marketing the idea that manufacturers can take back control of returns. "A lot of retailers and manufacturers used to focus on the front end, only to lose profit through the back door," he said.

For some special promotions, SiRAS ER has reduced improper returns from the nine percent range to around two percent.

Return rates on products with fast-changing technologies such as printers and digital cameras are extremely high, Junger said, whereas returns in mature product categories like television sets are lower. On average, products tracked by SiRAS have realized from between twenty and fifty percent reductions in returns depending on the manufacturer and retailer.

"We can lock down returns," said Junger. "With a registered serial number it is impossible to fool the system."

Glenn Mauney, senior vice president of manufacturer solutions for reverse logistics pioneer Genco, said savings realized by new technologies to support reverse channel management has brought the returns process to the attention of upper management, opening the door to more investment in reverse networks.

"Companies are being asked by their accountants to make them feel that they have the returns process under control," he said. "The impact of real-time visibility has been a boon to returns management."

Today's sophisticated returns management processes and technologies have evolved with stunning speed. Before Sciarotta took over as director of returns management for Philips in 1998, the company's returns had never been analyzed in any systematic way. Even though returns were costing the company tens of millions of dollars annually, the company didn't know why products were being returned and had no standard measurements for categorizing returns. Initiatives involving product redesigns were undertaken to improve consumers "out-of-box" experiences with complex electronic products, and Sciarotta developed a series of standards in which defective goods were handled differently from other returns. Cross-departmental strategies were implemented.

Since undertaking returns reduction efforts in 1998 as part of an overall reverse logistics strategy, Philips has saved over \$100 million annually and reduced annual returns by over 500,000 units.

Mauney said that electronic registration for products with high price points makes sense, but it has not taken hold for lower-value goods.

Some clients, notably Proctor & Gamble, have a zero returns policy in which all returned products are disposed of in either liquidation, donation of some other channels rather than returned, said Mauney.