A GENCO WHITE PAPER

GENCO SUPPLY CHAIN SOLUTIONS

Retail Store Returns:

How earlier disposition can reduce costs and maximize recovery value

Every day, retailers ship thousands of truckloads of returns back to product vendors – the original manufacturer or distributor – for final disposition. This return trip incurs significant costs to ship, store, and handle the product until it is returned for credit, refurbished, resold, or recycled. As time and costs are added, the value of the product erodes, reducing potential cash recovery.

Solutions exist to manage disposition of returns directly at the retail returns center to avoid these costs and speed the cash recovery cycle. But most product vendors manage the entire disposition process. They might wish to reconsider an in-house disposition strategy, since processing costs often exceed any added recovery value they might achieve.

Product vendors should be concerned not with the dollar value they receive for returns, but with the "net recovery value" – the recovery value minus the costs to carry and process that inventory. By managing product disposition direct from the retail returns center, product vendors can realize a 25 to 50 percent improvement on net recovery and contribute hundreds of thousands, even millions of dollars in added profit to their bottom lines. Retailers win, as well, by avoiding a portion of these processing costs and receiving vendor credits faster for improved cash flow.

CONTENTS

The Problem: Millions are spent to process products with diminished value

The total retail value of returns is estimated at $219 billion annually (source: National Retail Federation). A large portion of this product is returned by the retailer to the product vendor for credit. The cost to transport and process this return to vendor (RTV) product is substantial, yet the average value realized is just 12.5 percent of the retail value (source: Aberdeen Group). Result: retailers and product vendors invest too much for too little return.

Why hasn't the issue become more of a lightning rod for cost-conscious retailers and product vendors? In part, it's because processing costs are buried within multiple P&Ls. The transportation budget does not isolate these costs. Likewise, warehousing costs to store and process RTV merchandise and marketing costs to sort and remarket the products are distributed across many departmental budgets. Disposition decisions are typically made without full visibility to the costs and their impact on profitability.

Let's look at where these RTV processing costs are buried. **Figure 1** illustrates the major cost buckets as product travels from the retailer's returns center back to the vendor.

- **Freight.** Most times product vendors pay the outbound freight from the retailer, but some vendor agreements require the retailer to absorb these significant costs.
- **Storage.** Space isn't cheap. Buildings need to be heated, lighted, and staffed. These costs are the same for new products as they are for less valuable returns. In warehouses that house both returns and new product, a "slot lock" situation could arise, where there is no longer the capacity to accept new, higher-profit product due to a glut of RTV product.
- **Warehouse labor.** Labor costs to receive and process returns increase with the number of times product is touched.
- **Resources to remarket returned goods.** Product vendors need a separate team to identify buyers and sell into the secondary market.

Another significant, but less obvious downside to extending the disposition cycle for returns is product devaluation. On high-turnover products like cell phones, price erosion can be 10 percent per month. To obtain the greatest return, product needs to be resold into secondary markets while consumer interest is greatest.

Figure 1: **Return-to-Vendor Product: A Costly Journey**

The Solution:
Accelerate disposition of returns to eliminate overhead and preserve product value

Product vendors can preserve more of a product's value and avoid millions of dollars in overhead costs by reselling or recycling returns earlier in the reverse logistics cycle – from the retailer's returns center. Yet most invest significant dollars and people to process returns themselves. Here are the common disposition strategies product vendors employ:

- Liquidation
- Repackage and sell as "new"
- Remanufacture/Refurbish
- Sell at outlet store
- Recycle
- Send to landfill
- Donate

Corporate concern with rising investments in these non-core disposition activities has spawned a growing and increasingly sophisticated market for third-party reverse logistics services. These third-party reverse logistics providers that once simply operated returns centers to receive and forward product for disposition are now performing sophisticated value-added services, such as product inspection and testing, repair, sorting and repackaging, and liquidation. In short, just about all the services product vendors manage themselves at their own returns centers.

Today, there is duplication of effort at the retailer and product vendor returns centers. For one major product vendor, returns are received at the retailer's returns center, assigned a unique license plate, labeled, scanned, and assigned a pallet before being shipped to the product vendor's facility. There, the product is pulled off the pallet, scanned, assigned a new license plate, labeled, and restacked on a new pallet. An almost identical process that is, for most products, completely unnecessary. What if that initial scan at the retailer's return center triggered both the store credit and the product vendor's credit back to the retailer? This approach would give the retailer immediate access to vendor credits and allow the product vendor to start the disposition process to expedite its own cash recovery cycle.

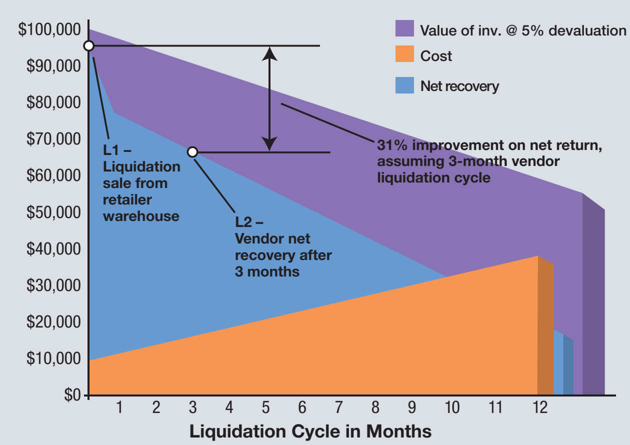
Taking that simple change further, a third-party provider could apply all of the product vendor's disposition rules at the retailer's returns center, essentially making and acting on disposition decisions according to the product vendor's exact specifications. It's the same process, but performed weeks earlier – avoiding the expense of processing and shipping product back to the product vendor. In addition to cutting time and expense, earlier disposition reduces inventory, enhances the balance sheet, and significantly reduces carbon emissions through reduced transportation.

The Opportunity: 25 to 50 percent improvement on net recovery value

As an example, let's do the math on returns that have an initial recovery value of $100,000 in the secondary market. **Figure 2** illustrates the combined impact of overhead costs and devaluation on the "net recovery" for this RTV product, where liquidation is the disposition method.

The purple area indicates the impact of time on product value, using a very conservative 5 percent devaluation rate. The orange area at the bottom indicates cost, assuming front-loaded processing costs of 10 percent and carrying costs at 25 percent per year. The light blue area indicates the product vendor's net recovery on this inventory, after devaluation and carrying costs. Here's how earlier liquidation impacts recovery value:

Figure 2: **Impact of Devaluation and Overhead on Net Recovery**



- **Immediate liquidation from the retail returns center.** A typical liquidation sales might yield a net return of $95,000. This assumes the product is sold within three weeks.

- **Product vendor liquidation from its own facility.** In-house resale cycles on RTV product are typically two to three months. Assuming a three-month cycle, a product vendor might generate a net recovery of $68,202 for the same product after product devaluation and overhead costs – a 31 percent lower yield compared to more immediate liquidation.

For a majority of RTV product, shortening the disposition cycle can improve net recovery by 25 to 50 percent. That's true whether the disposition method is simple liquidation or one that requires value-added activities, such as inspection and testing, repacking, or refurbishment.

Let's examine the logic of earlier disposition for major resale and recycling strategies.

Liquidate. Immediate liquidation from the retail returns center avoids processing costs and maximizes recovery value by avoiding further product devaluation. The accompanying sidebar, "Don't hesitate. Liquidate." examines the advantages of more immediate liquidation of returns.

Recycle/destroy. Products that are recycled have little to no market value. Any expense incurred is lost profit. To remove this inventory from the books faster, a third-party reverse logistics provider can manage recycling out of the retailer's facility. These providers work with recycling partners to ensure maximum recovery value and disposal methods that meet all environmental and sustainability requirements.

Refurbish. Product vendors may send a portion of their returns to third-party repair partners, further extending the resale cycle. Many of these same services can be performed at the retailer's returns center by a third-party reverse logistics provider with repair experience. Or, the third-party reverse logistics provider may sub-contract to have more intricate repairs performed within the facility to save time and the significant expense of shipping to and from outside repair partners.

Re-kit and re-package. Many returns are either like new or fully functional products that may have a missing component or slightly damaged package. The quicker these products are transformed to market-ready status, the higher their market value. A typical scenario would be a shipment of returned DVD players, of which 30 percent don't work while 70 percent are fully functional, with the exception of a missing accessory. The re-kitting process may require taking accessories from non-functional players and using them to complete fully functional ones. These types of value-added activities are common for select third-party reverse logistics providers, who have the systems to manage the most complex kitting requirements.

De-manufacturing. For a portion of high-value inventory, such as flat screen TVs and personal computers, the cash generated from selling the sub-assemblies may exceed the net return from repairing faulty units and reselling them in the secondary market. A profitable de-manufacturing strategy requires a thorough knowledge of the market for these sub-assemblies, including their market value. This market knowledge is a core focus for leading third-party reverse logistics providers who can assess the inventory to determine if de-manufacturing is a profitable strategy.

When it comes to disposition of returns, time is the enemy. To maximize net recovery value, product vendors should resell or recycle products as quickly as possible to avoid further devaluation and the significant costs associated with extended disposition cycles. Third-party reverse logistics providers enable faster asset recovery by performing or managing disposition activities out of the retailer's returns center. Of course, retailers will only allocate space for these activities if there are clear financial incentives. These could include underwriting a portion of their space costs and improving cash flow through immediate application of vendor credits for returns.

Don't hesitate. Liquidate. The advantages of third-party liquidation of returns

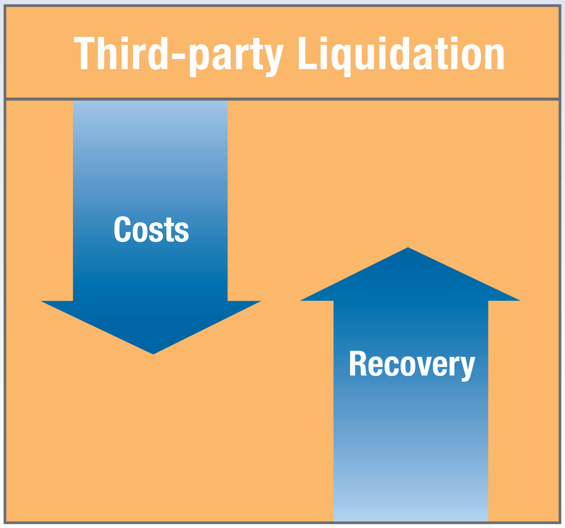
Many product vendors invest freight, labor and storage costs to process returns at their own facilities, only to liquidate the products in bulk when they arrive from the retailer. Liquidating from the retailer's returns center can avoid these costs and generate similar or higher recovery rates.

For some products, immediate liquidation is clearly preferred over extending the disposition cycle. Heavy freight like large furniture can yield a good recovery value, but not good enough to warrant the high transportation cost and damage risk. Low-value items like toothbrushes and combs have limited recovery value and would not be worth the extra freight and processing costs.

Over the last 10 to 15 years, product liquidation has become a large and increasingly sophisticated industry. Leading third-party reverse logistics providers have invested in the high-level expertise and technology required to transform product liquidation from a "necessary evil" into a profit center for both product vendors and retailers.

Here are the advantages that leading third-party reverse logistics providers can bring:

- **Fast cash.** In many cases, they will purchase the inventory outright, generating immediate cash for the retailer or product vendor.
- **Reduced cost.** They have developed extensive buyer networks that enable them to sell large amounts of inventory quickly and avoid the expense of extended disposition cycles.
- **Brand protection.** They can monitor compliance with resale restrictions. Some employ a compliance manager who monitors buyer compliance with the retailer's or product vendor's sale terms.
- **More efficient processing.** They have invested to automate product receipt and sortation. Systems track products using bar code scanning as they move through the sorting process and generate manifests as loads are built for resale.
- **Higher recovery rates.** They have multi-channel sales strategies designed to yield the highest return possible based on the product condition. These channels include bulk truckload and pallet sales to other businesses, and unit sales to bargain hunters. Specially designed software uses product characteristics to assign products to the highest-yielding liquidation channel.
- **Greener planet.** Liquidation is inherently a "green" activity since it promotes reuse over landfill disposal.



The Barriers: Why costly and extended disposition cycles persist

Despite the 25 to 50 percent improvement on net recovery value from earlier disposition of returns, product continues to flow back to product vendors for processing. Here are the major reasons:

- **Brand protection.** Many vendors want "cradle-to-grave" control of their products to protect the integrity of their brands and retail pricing. They don't want the same products being offered for less through readily available secondary channels. In response, leading third-party reverse logistics providers have developed advanced brand protection services, including brand name defacing and administration of channel restrictions (strict terms and conditions under which product must be resold). These services, plus export capabilities, can alleviate most brand protection concerns.

- **Warranty protection.** Some product vendors of high-value consumer electronics may need to control product to the unique serial number level. Leading third-party reverse logistics providers can capture and provide retailers and product vendors with serial numbers for all liquidated product, allowing them to remove these specific products from warranty protection.

- **Established agreements between retailer and product vendor.** These financial arrangements are negotiated up front, however they can and should be reviewed regularly to ensure maximum recovery value for both parties.

- **Inability to isolate RTV-related costs.** Costs to process RTV products are distributed across many departmental budgets, making it difficult to gather the financial facts needed to support a strategy change. Any project to analyze RTV costs should be sponsored by an executive with broad P&L responsibility.

- **Validation of retailer credit.** Retailers take credits against returns, so product vendors want to see the actual product to validate that credits are accurate. Third-party reverse logistics providers can supply vendors with an electronic bill of lading detailing each returned product available for resale. This allows product vendors to reconcile inventory without the expense of bringing it back into their facility.

Determining the right disposition strategy

How do you determine whether earlier disposition of returns makes sense? Crunch the numbers. Compare the current processing cost with the product's recovery potential.

Companies that do this often make the mistake of comparing *all* processing costs with the *total* value recovered for returns. Such an aggregate analysis fails to recognize that each product category has unique processing requirements and recovery potential. What's needed is a *product-level analysis* to determine the optimal disposition strategy for *each product category.*

Product vendors and retailers can struggle with this type of analysis because they lack a broad knowledge of the secondary market, where liquidated and refurbished products are resold. In these cases, they should engage a third-party reverse logistics provider experienced in product disposition. Specialized third-party reverse logistics providers maintain a database of recovery rates by product category and have modeling tools that can estimate the financial return on vendors' investments in particular disposition strategies.

Figure 3: **A "Smart Return" Process.** Most RTV product goes through the exact same disposition process, but it is possible to analyze product, process and market data to determine the best disposition strategy by product type. Below are the components of an analysis designed to assess whether retail returns should be processed by the vendor or immediately liquidated from the retail returns center.

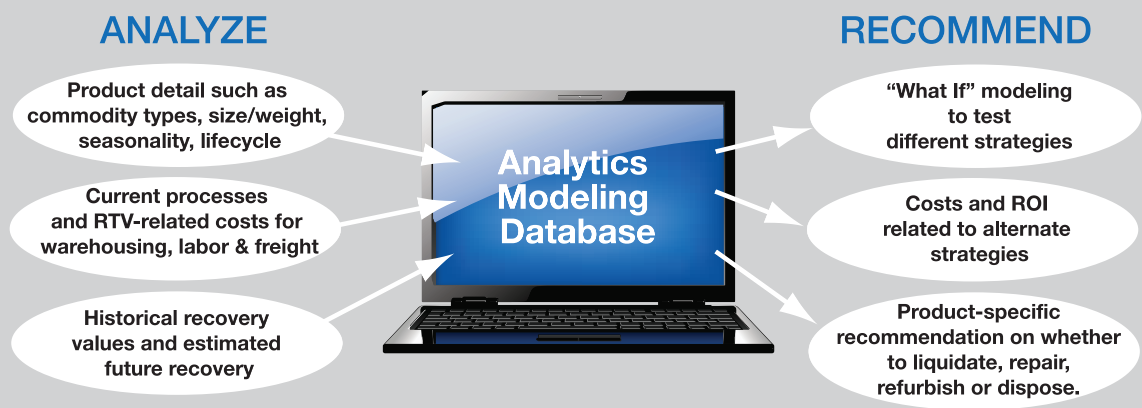


Figure 3 illustrates, at a high level, the assessment methodology that specialized third-party reverse logistics providers follow.

To do an effective analysis, a third-party reverse logistics provider will need the retailer and/or product vendor to provide details on the products, current disposition strategies, and recovery rates. This data enables the provider to model different disposition options for each product category to determine which strategy maximizes recovery value at the lowest cost.

The Conclusion: Choose disposition strategies that deliver the best net recovery value

Billions worth of returns are sent back to product vendors for disposition. This return trip requires major investments in freight, storage, and labor.

Product vendors should calculate their net recovery value on these assets after assignment of overhead costs. When these overhead costs offset any added recovery value achieved through in-house disposition, product vendors should consider making and acting on disposition decisions at the retailer's returns center. These facilities are often operated by third-party reverse logistics providers capable of handling most or all disposition activities.

To determine the right disposition strategy, product vendors should analyze processing costs and recovery potential for each class of product sold. Assistance for such an analysis is available from qualified third-party reverse logistics and asset recovery providers, who can offer recommendations that could yield substantial, bottom-line savings. ■

GENCO Supply Chain Solutions is North America's 2nd largest and a Global Top 50 third-party logistics provider and the recognized leader in reverse logistics. The company manages 125 operations and 37 million square feet of warehouse space throughout North America for a diverse range of retail, manufacturing and government customers.

GENCO SUPPLY CHAIN SOLUTIONS

100 Papercraft Park,
Pittsburgh, PA 15238

1-800-378-9671
Smart@genco.com
www.genco.com